

HUNTON & WILLIAMS

**HUNTON & WILLIAMS
USAID UKRAINE**

**ENERGY LEGAL, REGULATORY
AND MARKET REFORM PROJECT**



Prepared for:

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8th QUARTERLY REPORT:
MARCH 2002 – MAY 2002

**HUNTON AND WILLIAMS - USAID UKRAINE
TASK ORDER OUT-EEU-1-800-99-00033-00
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8th QUARTERLY REPORT: MARCH 2002 – MAY 2002

OUTLINE OF 8th QUARTERLY REPORT

This report summarizes the conditions found and results achieved for the period from March 2002 through May 2002 (8th Quarter), the current status of work, and anticipated activities in the near to medium term. Unique additions to this Report are Annex G, which summarizes results of our work with the WEM Concept Commission, and Annex J, a representative internal assessment document.

This report consists of the following sections:

- **Part A** Outline Of Project Purpose And Focus Of Work.
- **Part B** Overview Of The Current Status Of The Project.
- **Part C** Relationship With Counterparts.
- **Part D** Support Of The Privatization Effort.
- **Part E** Activity For International Privatization Task Force And Donor Community.
- **Part F** Training and Study Tour Program.
- **Part G** CBM, Fuel Research and Other Activities.
- **Part H** Main Project Activities Register
- **Part I** Register Of Activities at NERC Office
- **Annex A** Documents Translated In Course Of Work With The NERC
- **Annex B** Documents Translated In Course of Other Work
- **Annex C** List of Letters Sent By The Project To Government Agencies
- **Annex D** List of Other Documents Produced By Our Staff.
- **Annex E** Computer Equipment Purchases For Counterparts
- **Annex F** WEM Concept Commission Overview
- **Annex G** Table of Results of WEM Concept Development
- **Annex H:** General Comments on the draft Regulatory Commission Law
- **Annex I:** Comments on the Licensing Provisions of the draft Regulatory Commission Law
- **Annex J** Representative External Consulting Advisory (file attached)
- **Annex K:** Presentation of Dispatch Analysis to US Embassy March 2002 (file attached)

A. OUTLINE OF PROJECT PURPOSE AND FOCUS OF WORK

Hunton & Williams was awarded Indefinite Quantities Contract EEU-I-99-00033-00 (the “IQC”) by the United States Agency for International Development (“USAID”) through which USAID awarded Task Order OUT-EEU-I-800-99-00033-00 (the “TOR”) to Hunton & Williams to provide certain legal, regulatory and wholesale electricity market advisory services in support of Ukraine’s energy sector privatization program (the “Project”). To those ends, we are expected to, and successfully do, work with diverse counterparts within the Government of Ukraine (“GOU”) as well as coordinate our activities with the international donor community.

Our work principally serves three functions, to:

- ***Strengthen the independence and functionality of the power sector regulator*** – presently the National Electricity Regulatory Commission (“NERC”);
- ***Improve the operation and governance of the wholesale electricity market*** (“WEM”); and
- ***Ensure the success of GOU’s energy sector privatization program*** in concert with USAID contractor Deloitte Touch Tomatsu (“DTT”) – the USAID contractor with primary responsibility to advise the State Property Fund of Ukraine which conducts the privatization of all state entities as the agent of the government.

To achieve each of these goals, we actively work with all GOU counterparts – the Verkhovna Rada of Ukraine (the “Verkhovna Rada”), NERC, the Ministry of Fuel and Energy (“MFE”) and Energorynok State Enterprises (“Energomarket”) – to identify the impediments to achieve our goals, develop precise mechanisms to remove those impediments and then implement those mechanisms.

Specifically, to strengthen NERC, we are implementing the following initiatives:

- Continue efforts to pass legislation that provides political and financial independence and establishes standards for regulation of the energy sector by NERC, by assisting NERC to completed a revised Draft Law by July 1
- Continuing to make the NERC tariff methodology responsive to the privatization effort and current market realities. In the 8th Quarter we assisted NERC to implement tariffs, provided NERC with detailed analyses of diverse technical tariff issues, and assisted to estimate the impacts of the “new” tariff method on the remaining 12 oblenergos to be privatized.
- Developing a transparent mechanism for modifying the NERC-established algorithm that controls the flow of funds through the WEM. In this quarter the Market Board and the NERC on several occasions approved an algorithm that allocates funds proportionate to transactions, with no distortions.
- Assisted development of a Resolution of the debt problems by offering “comments” on a plan and draft law proposed by the Ministry of Fuel and Energy, as part of a joint USAID effort to support a common Donor position on debts.

To improve operation and governance of the WEM, in the current period we have been working in the following areas:

- Improving operations within the existing WEM structure to allow for transparent functioning of the existing WEM framework established through the Members’ Agreement.
- Preparing the WEM to become a fully functioning true market Hunton & Williams continued intense participation in the “WEM Concept Commission” as representative on behalf of the Donor group, continued intense staff participation in the “WEM Working Group,” doing the daily work to develop the concept, and continued providing the staff and support office for the “Commission Secretariat” that assures the proper preparation and flow of documents for the WEM Concept Commission. The WEM Concept Commission will

decide whether legislation is needed or whether improvements can be completed without legislation.

To ensure the success of GOU's energy sector privatization program, we undertook the following in the 8th Quarter of project activity:

- Worked closely with the NERC to implement the tariff procedure and to develop a new law on NERC independence;
- Regularly met with existing and potential strategic investors to share our knowledge on legal and regulatory issues impacting the energy sector, and to work out strategies for addressing legal and regulatory issues strategic investors face within the Ukraine WEM environment;
- Supported the International Privatization Task Force created by GOU and the international donor community – consisting of USAID, the European Bank for Reconstruction and Development (“EBRD”), the International Monetary Fund (“IMF”) and the World Bank (the “Task Force”) - through drafting joint documents and implementing the action items emerging from Task Force meetings.
- Worked with DTT to coordinate efforts among the international donor community to ensure a common focus on and support of an acceptable outcome for GOU's energy sector privatization, including on debt issues.
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B. OVERVIEW OF CURRENT STATUS OF THE PROJECT

B.1 SUMMARY OVERVIEW OF 8th QUARTER

The design and implementation of the Hunton and Williams project remains as summarized in the December 2000 Inception Report, which was also our Second Quarterly Report. However, the primary emphasis of work shifted dramatically in the 8th Quarter, with the advent of work in connection with the “WEM Concept Commission”. Annex F gives an overview of the purpose and results to date of the WEM Concept Commission. This Commission became active in late January. Annex G summarized what objectives Hunton & Williams have achieved in the detailed construction of the Concept. Annex G is also the supporting document for our discussions in other Parts of the Quarterly Report, including Part B.2.2 below.

Because of the multiple roles of Hunton & Williams or its staff on the WEM Concept Commission our efforts in the quarter therefore focused on that process. Our roles may be summarized as follows. First, the Deputy head and effective working chairman of the Concept Commission is NERC Commissioner Kotko, for whom we act as advisor in our role as consultant to the NERC. We have also however assisted especially the Energomarket, an active participant in the Commission process, and others as requested. Second, our project economist, Ilka Lewington, sits as a representative of the Donor Community, and therefore has participated in the meetings of the Commission itself, and also kept the Donor Community actively briefed on developments and sought their views as issues have developed. Third, Hunton & Williams as such was appointed by the WEM Concept Commission as a member of the WEM Concept Working Group, which meets almost daily to do the detailed development. In that role, Hunton & Williams staff have researched and developed many of the documents that supported technical deliberations, or which will form part of the final Concept. Fourth, Hunton & Williams provides the administrative staff and some equipment to support the Secretariat of the WEM Concept Commission, which controls and disseminates the many versions of the many documents considered and eventually to be adopted by the Commission. As a result nearly all of our professional and even support staff have been involved for some significant part of their time on WEM Concept Commission activity. Four staff have devoted essentially full time to WEM Concept Commission work, our project economist Ilka Lewington, attorneys Anna Ryzhova and Victoria Dodonova, and our librarian Elena Belonozhko, while most other staff have found from perhaps one quarter to one half of their time on that project. Paul Ballonoff has supported WEM Concept Commission work by providing analysis of debt issues, and providing quantitative analyses of the impacts of various proposals. He also presented the “H & W Model” to a meeting of the WEM Concept Commission, to avoid mischaracterization of the model as a

“Donor” model, which would have been the inference if Ilka Lewington made that presentation to the Commission. As illustrated in Annex J, we have also used external advice on WEM technical issues.

Hunton & Williams continues to work extensively with the NERC to implement the NERC Tariff method. The NERC process requires a fixed time limit for the complete review and decision on each application, including an open public hearing process. Government interference delayed implementation of the previously approved tariffs, pending development of a mitigation procedure. Since then, we have helped assure that the required implementation, including mitigation, has taken place.

In April 2002 the NERC was appointed by the President, as well as by the Cabinet of Ministers, to be the lead agency to develop a new draft law on NERC structure and function. NERC thus also appointed Hunton & Williams as a consultant to their interagency body that is drafting that law. The draft started with the version of a law on NERC independence previously drafted by the Fuel and Energy Complex Committee of the Verkhovna Rada, with Hunton & Williams assistance, in 2000 and 2001. The NERC is required to complete a draft and submit it to the Cabinet of Ministers on July 1 2002. The Cabinet of Ministers in turn expects to submit the new draft NERC Law to the Verkhovna Rada on September 1 2002.

Hunton & Williams continued to develop and use its quantitative modeling capabilities in support of project objectives in the 8th Quarter. Although our project contract contains no specific task nor any deliverable that requires creation of analytical programs, as it has become necessary in the course of our work, we have developed analytical tools. Thus, in the course of our work supporting the NERC in developing and administering retail tariffs, from December 2000 to the present, we developed a series of spreadsheets that perform retail level tariff analysis. In assessing our concept of WEM market reform, we created a “financial model” of the operation of the WEM which resulted for example in the Quantitative Analysis we delivered in December 2001 to USAID and to our counterparts, and in our presentation for the USEA “Genco Summit” in January 2002. We have since then also developed a “dispatch” analysis that enables us to simulate, in simplified form, the dispatch operations of the thermal sub-market, and to assess the impacts of these operations. In March we presented results of this analysis to USAID, and separately to the US Embassy, and supported the US Embassy to develop a speech for the Ambassador in May, using results of that analysis. Some details and results of the financial model and of the dispatch model were also described in Annexes F and G to our 7th Quarter Report. Annex K to this 8th Quarter Report is our presentation of dispatch analysis results to the Embassy on March 23 2002.

In May 2002 various agencies of the Government became more active in working on solutions to the power sector debt problem. Thus in May Hunton & Williams assisted USAID and the Donor group to develop a Joint Donor position in response to proposals especially of the Ministry of Fuel and Energy. We commented on the Minister of Fuel and Energy’s draft law on debt issues, and on a related plan to implement steps for solutions discussed by that law.

B.2. ASSESSMENT OF COMPLETION OF PROJECT OBJECTIVES TO DATE

B.2.1 Purpose of this Discussion

This section allows periodic comparison of the project to date against the contract purposes. The Hunton & Williams contract for this project is a “performance” contract, which has general objectives and specific “Benchmarks” which seek to measure the achievement of those objectives. The contract objectives have been constant through the contract term, but the Benchmarks have been changed. Part B.2.2 summarizes our contract purposes and related benchmarks as defined by the performance criteria of the Contract. Part B.2.3 summarizes the Benchmarks related to the NERC. Part B.2.4 summarizes benchmarks as related to improving performance of the WEM.

An overview of our performance through end February 2002, compared to those criteria, was given in this Part B.2 of our 7th Quarter Report. Here, we update for new events since that 7th Quarter Report.

B.2.2. Contract Statement of Performance

The required performance of this contract is stated at its Part D as follows:

“The contractor shall make best efforts to achieve the results of the ‘Ukraine Energy Regulatory and Legal Support’ program which are: the creation of a sound regulatory, legal and market development bases [sic: basis] in which soon-to-be-privatized oblenergos can operate effectively and profitably without undue government interference”

Our initial contract of May 2000 contains four Benchmarks, which were replaced in June 2001 by three Benchmarks. Thus the May 2000 Benchmarks guided our performance for the first approximately 14 months, and the June 2001 Benchmarks have guided our work since that date. We organize the discussion below by the specified Benchmarks.

B.2.3. Statement of NERC Related Benchmarks

The May 2000 Benchmarks related to NERC were:

- 1) *Support for passage of legislation pertaining to the wholesale electricity market and to strengthening the legal basis for NERC.*
- 2) *Support for NERC functionality and independence as measured by:*
 - a) *NERC revenues deriving from monthly license assessment at an appropriate level;*
 - b) *NERC Reports at a Presidential Level;*
 - c) *Commissioners are not dismissed for political reasons prior to term expiration.*

In addition, it was clear that a major implied May 2000 Benchmark, related to achieving actual investor participation, was to provide investors with an opportunity to “operate profitably.” This necessarily required developing an appropriate retail transmission and supply tariff.

These Benchmarks were replaced in June 2001 by this text:

- a) *Successful implementation of NERC-approved tariff methodologies.*
- b) *Passage of a NERC law that strengthens the legal independence. If feasible, attempt to introduce a Constitutional Amendment to insure NERC’s exemption from central budget funding. (June 2001)*

B.2.3.2. Evaluation of Achievement of NERC-Related Benchmarks:

Support for a NERC Law: Our 7th Quarter Report at this section reviewed the work to date to pass a law strengthening NERC independence. In April 2002 the NERC was instructed by the president and separately, by the Cabinet of Ministers, to draft a new NERC Law and to provide that draft to the Cabinet by July 1 2002. NERC then appointed an intergovernmental working group to advise it on that draft, and named Hunton & Williams as consultants to that working group. We have been actively supporting that process, which expects to meet the required deadline. Evaluation: this objective is not yet achieved, but we remain optimistic that it is possible in the term of our contract (by end April 2003).

NERC Funding: May 2000 Benchmark 2 a) has the intent of creating financial independence for the NERC, by dedicating adequate revenues derived from license and regulatory fees. The draft law mentioned in the paragraph above contains language that could achieve this purpose. Evaluation: this objective is not yet achieved, but we are now more optimistic that it is possible in the term of our contract (by end April 2003).

Design and Implement Tariffs Acceptable to Investors. NERC continues to treat tariff issues within their published method and within their published procedural timeframe. We continue to support NERC in tariff analysis for both the previous oblenergos previously sold, and for analysis of impacts of oblenergos pending sale. Evaluation: successfully achieved to date.

NERC Reports at a Presidential Level. See the 7th Quarter Report for analytical discussion. Evaluation: while the nominal purpose has been achieved, the substantive purpose requires that the June 2001 Benchmark b) as to a NERC Law, be also achieved. We continue to believe this is likely during our contract term.

Non-dismissal of NERC Commissioners for Political Reasons Achievement of this May 2000 Benchmark 2 c) is also embodied in the passage of a NERC Law. See the 7th Quarter Report for analytical discussion. Over the last eighteen months, NERC has gained the perception of being a well functioning and broadly respected agency. It has reached this status by managing several difficult issues, including most especially tariff and license issues, under severe pressures from political departments. Thus, the NERC Commissioners at present are often seen as taking leading roles in resolving important sector problems. A good illustration of this is the role of the NERC in management of the WEM Concept Commission. Evaluation: achievement of this Benchmark is likely during our contract term, by passage of a NERC Law. The objective is also currently strengthened by the improved public image of the Commission as a competent agency, thus reducing the likelihood of removal of a commissioner for improper reasons.

B.2.4. Statement of WEM-Related Benchmarks

The May 2000 Benchmarks that related to the WEM were:

- 1) Support for passage of legislation pertaining to the wholesale electricity market and to strengthening the legal basis for NERC.*
- 3) The number of days the Energomarket is in an Emergency status shall be gradually reduced to zero over the contract period (as a result of the elimination of the central account).*
- 4) Investors can engage in bilateral contracts.*

Note that Benchmark 3) also relates to NERC, which actually declares the emergencies, but is classified here for convenience since the algorithm also related to the WEM.

The revised June 2001 Benchmarks related to the WEM are:

- c) Successful evolution of WEM laws and policies to 1) reduce or eliminate emergency status and associated funds diversion; 2) permit Oblenergo owners that pay for electricity to enjoy normal commercial banking practices (e.g. selection of their own bank); 3) Permit greater decentralized purchasing from the WEM in the context to be established by generation privatization policy and a continued philosophy of cash only payment.*

B.3.4.2. Evaluation of Achievement of WEM Related Benchmarks

In the 8th Quarter our participation in the WEM Concept Commission, discussed in various parts of the Report below, dominated our activities. The detail analysis of relative achievement of specific objectives of this performance is summarized in Annex G.

Reduce or eliminate declarations of emergency. Level. See the 7th Quarter Report for analytical discussion. In the course of the WEM Concept Commission we have achieved agreement in principle that the allocation of funds in the upper level algorithm will occur only by “proportionate allocation” of funds by quantities actually delivered to the market at the prices calculated according to market rules; and that this principle will be embodied in a law to be proposed to the Verkhovna Rada by the Cabinet of Ministers as part

of the WEM Concept proposals.. Evaluation: Probably achieved in significant part. But assurance will be higher if and when the required law is actually passed.

Full payment to allow for full supply: Level. See the 7th Quarter Report for analytical discussion.. The Cabinet has in fact revised Resolution 441 to assure that oblenegors who have previously paid in full are not curtailed in current periods. Evaluation: Important progress has been achieved. Removing remaining government limits on demand we believe can be achieved within our contract term. However, in so far as this also requires liberalization of the fuels markets, we make no prediction, nor do we currently have a specific mandate to work on fuel market liberalization tasks.

Liberalized purchasing by market members: The WEM Concept Commission has adopted as the prospective WEM structure, open direct contracting, with a residual balancing market for what is not contracted and for technical services. The transition period to this result, in 2 to 3 years, will assure a gradual implementation of direct contracts. Evaluation: tentatively achieved. Depends on final outcome of WEM Concept Commission design and on subsequent actual implementation.

Continued cash only payment philosophy: In contrast to the situation as analyzed in the 7th Quarter Report, we believe that the issue of WEM design is now de-linked from the conflicting policies of other Benchmarks, due to the effective operations of the WEM Concept Commission, and to the changed political framework for development of a new law on NERC independence. Evaluation: Implementation of increased cash payment has been successfully achieved and the progress maintained.

WEM operational improvement and WEM Concept Commission: Achieving the May 2000 Benchmark 1 in so far as it relates to the WEM, the May 2000 Benchmark 4), and the June 2001 Benchmark c)3) have continually absorbed a significant part of the efforts of this project, as indeed was the intended design. This was demonstrated by the intense activity of the project in the 8th Quarter in supporting the WEM Concept Commission. That body has been able to successfully address many diverse technical and political issues that must be resolved. The "WEM Concept Commission" (see Part C.6 below) was appointed by the Cabinet of Ministers to be under the effective control of the NERC. It is self-defined to implement a staged process of changes, to be embodied in normative documents of the NERC and of the Cabinet of Ministers. The WEM Concept Commission is currently a very active body under the administration of the NERC. In this process Hunton & Williams project staff sit on the executive body (the "Commission" itself) as representative of the Donors, on the daily working body as Hunton & Williams, and as the most active participant, and on the Secretariat by providing staff to maintain actual control of the flow of documents. Evaluation: In the context of the WEM Concept Commission, we have to date achieved agreed statements of policy that if implemented, would achieve essentially all of these objectives, assuming the Concept as drafted to date is accepted by the Cabinet of Ministers and put into force.

C. RELATIONSHIPS WITH COUNTERPARTS

C. 1. BACKGROUND

The TOR identifies four primary counterparts for the Project: NERC, the Energomarket, the Verkhovna Rada, and the MFE. The Memorandum of Understanding between the Government of the United States and the GOU, dated _____, ("MOU") created the basis for establishing the relationships with the GOU counterparts identified in the TOR. We summarize our work to achieve Project goals with each GOU counterpart below.

C.2. NATIONAL ELECTRICITY REGULATORY COMMISSION

In 1996, in part through the efforts of USAID, the President of Ukraine created NERC by decree as an independent energy sector regulatory commission. Supporting NERC's continued development and working with NERC to support GOU's privatization effort remains a key focus of our Project. Project relations with NERC are good, bolstered, in part, through our second Project office located within the NERC

building. We meet with NERC counterparts daily and have routine meetings with the Chairman and other commissioners to discuss and coordinate on-going issues. As in prior quarters of the Project, four issues continue to dominate our work with NERC: the draft law on regulatory commission independence; tariff methodologies and rate design; due process; and the Wholesale Electricity Market algorithm. Significant issues on which we are currently advising NERC are briefly discussed below. In addition, our work in Wholesale Energy Market reform, through the “WEM Concept Commission”, is taking place through NERC auspices, but is discussed separately in our discussion of market issues.

Related work with the NERC covers a wide range of advisory services, as described below, and as summarized in Part H, the NERC Activity Register, and Annex A the List of Documents Translated for NERC.

C.2.1. Regulatory Commission Law

In April 2002 the Cabinet of Ministers, and separately, the president, requested the NERC to take responsibility for creating a new draft law on NERC structure and function, to coordinate creation of that draft law with other relevant Ministries, and to submit the draft law to the Cabinet of Ministers by July 1 2002. The Cabinet of Ministers must then submit a proposed law for consideration to the Verkhovna Rada by September 1 2002. Concurrently, the NERC and the staff of the Fuel and Energy Complex Committee of the Verkhovna Rada have continued to review the NERC law for purposes of compliance with the requirements of the European Electricity Directive, for purposes of European Integration.

To assist in both activities, Hunton & Williams expert on European Integration, Steve Horvath of the Hunton & Williams UK office, came to Kiev for one week at the end of May 2002 to consult on development of the law. Mr. Horvath spent several days in detailed discussions with our own staff developing concepts to strengthen the law. He also then had two half-day meetings with NERC Commissioner Goncherova and her legal staff, who are directly responsible for development of a law. The NERC began its task with the previous version of the law, developed with our assistance last year. With our continued advice NERC has added or is considering to add, text on these areas: (1) financial independence, by assuring that that revenues paid for license and regulatory fees are used only for NERC requirements; (2) political independence, by seeking to define areas of NERC “exclusive” authority and thus to remove Cabinet of Ministers interference; (3) improved license and dispute resolution authority to comply with European requirements; and (4) improved ability to define and monitor licensee performance standards.

Attached as Annex H: are our General Comments on the draft Regulatory Commission Law. Attached as Annex I: are our Comments on the Licensing Provisions of the draft Regulatory Commission Law. Our comments proposed the concept of the NERC exclusive powers. Incorporation of this concept to the Law will allow the courts to hold illegal acts, which interfere directly or indirectly with the NERC’s exclusive powers. We reasoned that the NERC’s exclusive powers should be: (1) establishment of tariffs for licensees in regulated activities; (2) issuance, suspension and revocation of licenses; (3) imposing penalties on natural monopoly entities and economic entities that carry out activity in the related markets; (4) control observation by the licensees of the license terms. To the functions and powers of the NERC we proposed to add licensing of dispatch, and developing and approving Electric Networks’ and Fuel Security Rules, equivalent to British Grid Code and Fuel Security Code.

C.2.2. Tariff Setting Methodologies and Rate Design

Hunton and Williams has been continuously advising NERC on the adverse effects that the existing cross subsidies have on pricing under the tariff setting methodology. However, simultaneously with the implementation of the tariff method NERC took measures on mitigation of the tariff increase impacts on the customers of six privatized oblenergos creating yet another cross subsidy. Thus, the six oblenergos collect their regulated revenue partially from own customers and partially from all customers of other oblenergos through a cross subsidy mechanism. However, consistently with the advice of Hunton and Williams, NERC has been gradually eliminating these measures to allow direct collection of total revenue of six oblenergos

from own customers. Currently the dead line for complete withdrawal of the mitigation measures and resulting cross subsidy is set on July 1, 2002. Hunton and Williams also assisted NERC in analyzing potential effects of application of the tariff method to the twelve oblenegos subject to privatization in 2002.

C.2.3 Draft Methodology for Services Additional to Those Licensed.

Considerable progress has been made by NERC on the issue of other than licensed services. Consistent with Hunton & Williams' advice NERC has identified the list of other than licensed services provided by the licensees in distribution and supply that are subject to price regulation. This list includes five "additional to licensed" services. NERC has drafted a methodology for pricing of these services. The draft methodology is based on a cost plus rate of return pricing. However, the draft methodology requires further elaboration in which Hunton and Williams is involved. This work is on going.

C.2.4 Information on International Experience on Activities Allowed Within the Distribution Business.

In the previous quarter Hunton and Williams provided NERC with a memorandum summarizing the international experience of activities included into the electricity distribution and supply businesses. After having reviewed this memorandum the staff of NERC Pricing Department realized that it would be reasonable to develop regulations outlining the list of regulated activities of the distribution and supply businesses. Hunton and Williams is involved in his work. The work is on going.

C.2.5. Distribution Pricing.

There have been no new developments on this issue in the 8th Quarter.

C.2.6. Pricing for Nuclear Generators.

In the 7th Quarter Hunton & Williams was requested by the NERC to comment on the draft tariff review procedure for nuclear generators, developed by NERC consultants. Hunton & Williams provided NERC with its comments and recommended further elaboration of the draft procedure. Subsequently in March 2002, the current quarter, during the public discussion of the draft procedure and consistent with the advice of Hunton & Williams, NERC decided to not approve the draft procedure and continue working on it.

C.2.7. Assistance in Simulation Analyses.

Hunton & Williams has been assisting NERC on an ad hoc basis in the analysis of the impacts of application of the new tariff method and other pricing policies. It is important for the NERC to be able to estimate the outcome of various regulatory decisions, especially those that involve setting prices. The work is on going.

C.2.8. Due Process and Regulatory Procedure

A third issue that permeates our work with NERC is to assist NERC in devising a proper governance mechanism, injecting notions of due process, rule of law, and proper regulatory procedure into NERC's work so that NERC's activities reflect international standards. An important development in NERC process was evidenced by the "open hearing" process used by the NERC for the tariff methodology. At suggestion of Hunton and Williams, the NERC decided to schedule the treatment of the tariff method through an open public hearing process. On its own initiative, in the previous quarters, the NERC also decided, and included into its Procedure for processing applications to change tariffs, that all such process be under open public hearings. By the end of the 8th Quarter, rate applications from all six new private companies under the new method have been subject to open public hearings, prior to the Commission accepting their content. We regard that as an important achievement of this project.

C.2.9. Due Process and Regulatory Procedure

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C.2.10. Algorithm Procedure

Hunton & Williams has been invited to attend the meeting of the WEM Working Group on the issues of changing the upper algorithm after the expiration of the Order of the Cabinet of Ministers of Ukraine # 45-p "On the System of Payments for Electricity" of February 14, 2001. Hunton & Williams observed the discussions of the Working Group members and subsequent decisions made by the WEM Board on this issue. Hunton & Williams wrote a letter to the WEM Board and the Chairman of the Working Group supporting the decision by which one hundred percent of cash received to the WEM from distribution companies is allocated between the generating companies in proportion to their monthly sales to the WEM. In this letter Hunton & Williams pointed out that there should be no further changes in the algorithm to avoid manipulation of the sector cash flows and the administrative interference into the activity of the Ukrainian electricity generating companies.

C.2.11. Procedure for Declaration of Emergency Situations on the WEM

There have been no new developments on this topic in the 8th Quarter. See this section of the 7th Quarter Report for history to date.

C.2.12. Conditions under Which Regulated Suppliers have the Right to Carry out Other Than Licensed Types of Activity

The Law of Ukraine "On Natural Monopolies," article 14, stated that the NERC should be entitled to impose conditions, for natural monopolies, regarding their entrepreneurial activities falling outside the sphere of their natural monopoly activities in case these activities have an impact on the natural monopoly market. At the present moment NERC does not have such any procedure for imposing such conditions. NERC receives a lot of requests from Licensees for permission to carry out other than licensed types of activities. Thus, it was important to establish defined requirements, which should be met by licensees in order to let them carry out other than licensed types of activity. At the present moment, NERC has already received comments of the Antimonopoly Committee on the draft Procedure. Ministry of Fuel and Energy are still considering a draft Procedure. Hunton & Williams will continue working on a draft Procedure, taking into account proposals of the other ministries as soon as NERC receives comments of the Ministry of Fuel and Energy.

Hunton & Williams continues advising NERC on the list of services, which are considered as licensed services for electricity supply at a regulated tariff and electricity transmission through local networks. We continue working intensely with internal committees of the NERC on drafting appropriate regulations.

C.2.13. Oblenergo Insurance Issues

See the 7th Quarter Report for details. This issue has been allocated by USAID to the work of the Commercial Law Center project. At NERC request we analyzed provisions of the new version of the Law of Ukraine "On Insurance" and prepared answers to several questions related to the legal requirements to creation of insurance company.

C.2.14. Regulatory Policy Law

The idea of a Regulatory Policy Law remains dormant in the 8th quarter due to the election of a new Verkhovna Rada and the efforts to reorganize the membership following that election.

C.2.15. Moratorium Law

The Moratorium Law, or Law of Ukraine “On Introduction of Moratorium on Compulsory Sale of Assets, was passed on 29 November 2001 by the Verkhovna Rada passed, including Presidential proposals for amendments thereto. The Moratorium remains in place. Except as noted in the sections on the bankruptcy laws, cited in our 7th Quarter Report, and which completed in the first week of the 8th Quarter as reported in the previous Report, there have been no recent activities related to the Moratorium Law.

C2.16. Law on Restructuring Sector Debts

Actions related to analysis of the sector debts are noted in the discussion on the WEM Concept Commission, listed in the table of Annex G, and summarized in the text below at Parts C.4.2, C.4.2.1 and C.4.2.2..

C2.17. NERC Regulations

Hunton & Williams worked actively with the NERC Legal Department on improvement of language of the NERC Regulations, which stipulate procedure for preparation and conducting of the NERC meetings. Hunton & Williams prepared comments to the NERC Regulations mainly for purpose of fair and transparent decision making with regard to introduction of changes and amendments to the WEM Algorithm. The work is on going.

C.3. ENERGOMARKET

Our work with Energomarket has continued on several fronts, particularly: (a) as assistance to improving internal procedures; (b) as assistance in working through issues emerging due to privatization of the oblenergos; and (c) as participation in working groups established by the WEM Board to address a wide range of problems of the current WEM functioning,

C.3.1. Metering Procedures Working Group

Hunton & Williams provides general advice to the WEM Board Working Group on “Metering Procedures in the Ukraine WEM” (Schedule 10 in the WEM Members’ Agreement). The Working includes specialists from generators, oblenergos, the Ministry of Fuel and Energy, Energomarket, NEC “Ukrenergo”, and is presided over by the NERC. The task of this working group is to rewrite the metering procedures, in line with newly developed “Regulations for the Head Metering System Operator of the Wholesale Electricity Market of Ukraine” which result from the initiation replacement of the meters in the WEM financed from the TACIS fuel gap project. Hunton & Williams was instrumental in advising the European Commission to undertake this task, which will allow for hourly metering at all WEM trading points. The General Meeting of the WEM Members of February 8, 2002 charged the Working Group to submit metering procedures for approval by the WEM Board. Revised procedures were completed by the Working Group in the 8th Quarter, with the assistance of Hunton & Williams. We especially provided summaries of experience of the UK pool and other markets on solving these problems. The yet unresolved issue is absence of a methodology to account for losses associated with the transit of electric power through substations of power plants; this is being developed by OJSC Lvivorgres, part of the Ministry of Fuel and Energy. A second working group recently appointed by the WEM Board involves improvement (automation) of the metering in the wholesale electricity market. This working group is headed by the representative of SE “Energorynok”, and only recently started its work. Hunton & Williams earlier provided ESE with the materials and advice on how such systems operate in other wholesale electricity markets.

C.3.2. Market Rules Working Group

Hunton & Williams provides general advice to the working group established by the WEM Board for the revision of the “Market Rules” (Schedule 2 to the WEM Members’ Agreement). The Working group is represented by specialists from generators, oblenergos, the Ministry of Fuel and Energy, NERC, NEC “Ukrenergo”, and presided over by Energomarket. This working group on a continuous basis suggests changes

to the Market Rules, as reform in Ukrainian wholesale market develops. The changes are adopted by the WEM Board and approved by NERC. In the 8th Quarter, based on advice of this working group, NERC has approved several important changes to the Market Rules, and issued number of resolutions, improving WEM operation. Most important of the changes made are:

- 1) Starting from March 1, 2002, a dispatch logger was put in operation. All dispatch commands are recorded at power stations and at the Central Dispatch Center at NEC "Ukrenergo". Based on the recorded data, SE "Energoynok" calculates exact payments to power stations (gencos) according to the Market Rules. These include markup for deviation from day-ahead dispatch schedule, and penalties for deviation from the commands of the dispatcher in real time operation. Before introduction of the dispatch logger, most of these market rules were not working, and markup and penalties were calculated without any financial consequences to gencos. NEC "Ukrenergo" is working on further improvement of the dispatch logger operation.
- 2) As the demand in spring drops substantially, NERC decided to experiment with regulation of the system marginal price (SMP). Hunton & Williams has advocated that the price caps for SMP be lifted, and allow actual competition to occur in the market. At the end of February, NERC formally lifted the price cap on SMP¹. However, NERC still requires that price bids to be submitted by thermal generators to the market be "formed based on the variable costs only". NERC by another Resolution also changed the 'floor SMP' on 12 April 2002, from 65 UAH/MW to 45 UAH/MW: this is the price in the periods when there is no price setting plant in the system. Loosening of the previously inflexible regulation of the SMP should be considered as the positive step in the attempt to move closer to market principles in price setting in the WEM.
- 3) Because thermal generators may not recover their fixed costs from SMP alone, Market Rules provide that generators are receiving capacity fee. As for removing caps on SMP, Hunton & Williams has previously advocated raising the level of the capacity fee. In April, 2002 NERC increased capacity fee paid to units which bid flexible capacity to the market. NERC revised the cap for capacity payment². to 150 UAH/MW, increased from 40 UAH/MW.
- 4) As also suggested by Hunton & Williams and recommended by the working group on Market Rules, NERC introduced another incentive payment to the generators, - the flexibility fee. This fee is paid to generators who can regulate their output in a wide band, thus supporting smoother operation of the Ukrainian power system.

We believe these measures improve the competitiveness and efficiency of market operations. NERC now needs to develop modeling capabilities to allow them to better anticipate effects of such actions. Hunton & Williams may assist NERC and the working group with advice on such type of the modeling.

¹ NERC Resolution "On the abolishment of the cap of the hourly price bid", No.195, 25 February 2002.

² NERC Resolution "On the calculation of the capacity payment", No. 252, 15 March 2002.

C.3.3. Market Governance Working Group

Hunton & Williams participated in the WEM Board working group on consideration of the NEC Ukrenergo proposal to be a Voting Member of the WEM Board and General Meeting of the WEM Members. At the request of the working group participants Hunton & Williams prepared the comparison table as to the allocation of shares of System Operator in charter capital of Market Operator in certain countries (Poland, Argentina, Spain and England). This issue is still being worked on by the working group. No decision has been proposed to the WEM Board consideration yet.

C.3.4. Market Structure Modeling

This section continues discussion of our models, first described in the 7th Quarter Report at its section C.3 7. Beginning concurrently with that research, Hunton & Williams had developed an extension to also model the possible economic dispatch of all of the thermal units owned by the five Ukrainian thermal generating companies. This work was completed by March 2002. On March 5 2002 we presented the results to the USAID in Powerpoint format. We were then invited to present a similar report to the advisory staff of the US Embassy, which we did on March 23 2002. The Embassy version of the presentation is summarized here as Annex K.

C.3.5. Market Analysis Consultations

Hunton & Williams project is organized to rely on local (Ukrainian) resources, on resident ex-patriot advisors, and selected external advice on technical issues. One of the main foci of the project is reform of the WEM. This has become an especially intense area of work in the last 6 months, with the operation of the WEM Concept Commission. Therefore, we have also directed our external advice to focus on this work.

Apart from Ilka Lewington, our part-time resident market advisor, we also regularly use advice of Ivan Adams, a power market consultant experienced in the Ukrainian market. Mr. Adams was also a key advisor for arranging our study tour for Ukrainian officials to the UK for analysis of power market reforms there, in 2001.

In November 2001, Mr. Adams produced an initial report for Hunton & Williams, which identified a number of specific recommendations for possible changes to the Ukrainian Wholesale Electricity Market (WEM). Since then, detailed discussions have taken place within the project, and in the forum of The WEM Concept Commission, concerning the implementation of changes to the WEM. Thus in the 8th Quarter we continued to ask for independent advice from Mr. Adams, especially on technical issues that arise in development of the WEM Concept.

Ivan Adams was thus available for telephone and e-mail consultation through the period, and visited Kiev for a week of direct consultation with counterparts. Following that trip, Mr. Adams prepared the summary document attached here as Annex J. Note that we treat written advice from Mr. Adams as a form of internal project self-analysis. We then apply his recommendations as tempered by our own assessment of issues and practical implementation. Thus, the attached report is intended as advice to Hunton & Williams, and was not presented in this form to counterparts. Mr. Adams does however consult directly with counterparts from NERC, the Energomarket, the Ukrenergo, and others, when in Kiev.

C.4. MINISTRY OF FUEL AND ENERGY

We continue to work with the Ministry of Fuel and Energy (MFE) as required on critical issues.

C.4.1 Sector Policy and WEM Structure

See our discussions of the WEM Concept Commission at C.6.

C.4.2 Sector Debt

While analysis of and solving the sector debt is not a defined task of Hunton & Williams, those issues are inextricably tied to issues of primary concern to our project. Therefore, we have in any event found it necessary to work on sector debt issues. In the course of the Quarter, the Ministry of Fuel and Energy, and separately, the State Property Fund, proposed draft laws related to restructure of the power sector debts. On request of USAID acting CTO Walter Hall, in May 2002 we developed a detailed analysis of the law proposed by the Ministry, and we worked with Deloitte and Touche and with the Donor organizations, to develop Joint Donor comments and a Joint Donor statement of position related to resolution of the debt issues.

C.4.2.1 Debt Analyses Completed in 8th Quarter

In the 8th Quarter Hunton & Williams participated in two processes related to resolving the power sector debt. First, the WEM Concept Commission identified “resolving sector debts” as a “problem” to be resolved. Our documents related to this are noted in Annex G. Our objective related to debts in the WEM Concept Commission process was to assure that the problem was indeed recognized, and to insert useful ideas on resolving the debts, into the process and thinking of relevant Government ministries. We were successful in doing both. The ideas we proposed through the WEM Concept Commission working group are summarized in section C.4.2.2.

Second, Hunton & Williams analyzed and commented on the Ministry of Fuel and Energy Draft Law “On Restructuring Debts of Entrepreneurial Entities of Ukraine Arisen from Incomplete Settlements for Electricity and Fuels” (hereinafter – “MFE Draft Law”). On 24 May 2002 the MFE Draft Law was distributed among Donor organizations for discussion and comment. Hunton & Williams analyzed and actively participated in discussion of the draft. The resulting Hunton & Williams analysis of the MFE Draft Law was accepted by the Donors’ organizations as their joint comment and delivered to the Ministry of Fuel and Energy.

In summary, Hunton & Williams comments to the MFE Draft are as follows. First, most measures on the sector debts do not require new law and could be enforced within the existing legal framework. In particular, inventory, debt assignment, write-off of debts, which are recognized as bad under the effective legislation and restructuring of debts among companies can be done under existing law. Second, some of the draft law procedures need clarification, such as, operation of accounts with special status, time period and terms of discount promissory notes redemption. Third, since write-off of tax debts, under the draft law, would cause changes in tax and budget legislation, offset schemes implemented by the CabMin, under existing legislation, seem to be more appropriate for this purpose. Fourth, measures should avoid creating new debt, which might happen unless transfer of generating companies’ debts to Energorynok SE is supported by an adequate and workable revenue stream.

C.4.2.2. Current View of Debt Solution

Hunton & Williams agree with the joint Donor position on resolution of the sector debt, drafted at the end of May based on discussions among Deloitte Touche, USAID, Hunton & Williams and Donors organizations, in reply to a proposed draft debt law and Plan from the Ministry of Fuel and Energy.

Based on the above analysis and our prior work, as of the 8th Quarter, we continue to believe that the sector debt, far from being an unmanageably large problem as often painted, is actually quite tractable and resolvable by means probably already within the tools of the Government. We do concur with the joint position that if it is wished to avoid payment of taxes that are part of the total debt, however, a new law is required.

Debt resolution under existing authority can occur if the Cabinet of Ministers, supported by other agencies, were to adopt the appropriate resolutions and implement them as follows. This list is similar to that given in our 7th Quarterly Report, and is also similar to document we delivered in the 7th Quarter to NERC Chairman Prodan, and in the 8th Quarter to the WEM Concept Commission Working Group sessions on debt restructuring.

The means we proposed to the WEM Concept Commission working group are:

- (1) write down or off-set all debts that can be removed by administrative means;
- (2) restructure debts of the oblenegros to the Energomarket, which have not yet been restructured, in the same proportion to the oblenegro plant in service as was done for the "first six";
- (3) require that the State Reserve, the Gencos and the Energomarket implement up-stream restructuring of debt up to the total amount of debt held by the State Reserve against Generators, including to complete the restructure up the line of amounts related to the restructured debt for the six oblenegros privatized in April 2001;
- (4) pass on the benefits of the restructured Nafotgas debt to Russia, to participants in the Energomarket in form of restructured debt of market members for fuel supplies;
- (5) authorize a special cost component in the WEM fees, to be paid to Generators and marked for repayment of that portion of their debt to fuel suppliers that resulted from the currency devaluation of 1998/1999 - which is a cost that was not previously charged to any consumers;
- (6) request the NERC investigate the relationship between the level of capacity-availability fees paid for generation and the ability of generators to pay off remaining debts, and adjust the capacity fee as appropriate, consistent with good economic pricing practices;
- (7) instruct that all state tax authorities with creditor claims on energy companies desist from initiating any claim in court for recovery of that debt, at least until all of steps (1) through (6) have been completely implemented;
- (8) instruct that all Government owned or controlled companies or entities, including the State Material Reserve, who are creditors of any Government owned or controlled energy company, desist from initiating any claim in court for recovery of that debt, at least until all of steps (1) through (6) have been completely implemented;

Note that items (7) and (8) mean "maintain the Moratorium Law in force" until the oblenegro and Genco privatizations are completed.

To emphasize the correctness of our belief that the debt problem is both tractable and within the existing authorities of the Government, we note developments known as of this writing (June 26 2002). First, item (4) above is in the process of being implemented, with 10 year debt restructures being offered to all generating companies by Naftogaz. Already to our knowledge this offer has been signed by at least one of the thermal companies. Second, the preliminary result of the inventory (step (1)) is already known, and is expected to be completed by early summer, reinforcing our long asserted belief that the inventory as such as not a difficult problem, and would be resolved quickly once the basic structural devices were known and accepted. Third, the extent of government owned and controlled debt in the sector is so pervasive that cancellations of that debt could result in obviating or minimizing the need for step (2). In sum, while the administrative details that must be managed by the Government may be extensive, the preliminary results seem to show that the problem is even more tractable than our previous analysis had indicated.

C.5. VERKHOVNA RADA

The Project design assumed we would maintain relationships with the Verkhovna Rada and, in particular, with the Fuel and Energy Complex (FEC) Committee. Based on priorities proposed by the FEC Committee and our ability to meet those priorities within the Project scope of work, we devised a legislative program focused on ensuring a more successful privatization and post-privatization operation of the power sector. Due to delays in the reorganization of the Verkhovna Rada following the March elections, we are also pending restructure of our relationships with the FEC Committee. Below we describe specific legislative initiatives on which we are advising the FEC Committee.

C.5.1. NERC Law

The political structure of developing the current version of the NERC Law differs substantially from the status in 2000 and 2001. Previously, the development of a NERC Law was entirely an initiative of the legislature, with minimal Government or even NERC involvement. Therefore we concentrated our effort within the legislative process. But now, the development of a NERC Law is a Government initiative, to which we have been appointed as advisors by the NERC.

Thus, the current status of our work on the NERC Independence Law is summarized in Part C.2.1. We are also working on this task with the staff of the FEC Committee, under the track “European Integration”. However, the two tasks have merged into the single current activity of assisting the NERC to draft a law. In September, when that law has been proposed to the Verkhovna Rada by the Cabinet of Ministers, we have discussed with the FEC Staff that we will resume working within the FEC process; we expect to assist in presentations of the NERC Law as a requirement of European Integration. We have also discussed relationships between the NERC process and the subsequent legislative process with NERC Commissioner Goncherova, who heads the current NERC drafting effort. As a result of that discussion, we anticipate this if the current process of drafting a law to be proposed by the Cabinet of Ministers does not result in a sufficiently strong law for political independence, that we will work with the Commissioner and the FEC Committee to re-insert the requisite clauses through legislative process.

C.5.2 Wholesale Electricity Market Law

A fundamental task of our Project is to improve the functioning of the wholesale market. Recently this activity has assumed major importance and affects our work with all our counterparts. Therefore, a description of current work on a WEM Law or WEM Concept is given separately under C.6. .

C.5.3 Energy Sector Policy Bill

Pending reorganization of the Verkhovna Rada, there has been no new activity on the Sector Policy Law.

C.5.4. GOU Bankruptcy Related Draft Law

On March 7, 2002 the Verkhovna Rada passed amendments to Law of Ukraine the “On Solvency Restoration or Recognition the Debtor as a Bankrupt,” (Bankruptcy Law) proposed by the Verkhovna Rada deputy, Mr. Zachosov. The amendments that passed related to a more clear division between pre- and post-bankruptcy creditors and overall a more clear process of identifying creditors. In addition, amendments defining the status, rights and liabilities of arbitration managers were incorporated into this law.

As it was discussed in the previous Quarterly Report, two alternative draft Bankruptcy Laws were considered by the Verkhovna Rada, one from the CabMin, and the other submitted by the said deputy. Hunton & Williams’s analysis of the CabMin version revealed that it did not meet the purposes of the Moratorium Law, might negatively influence the energy sector and create numerous collisions with several other laws. Our concerns related the CabMin draft law reached the Verkhovna Rada in the joint Donors’ letter.

C.6. WORK WITH ALL COUNTERPARTS ON WEM REFORM

C.6.1 Prior Developments

As described in our prior Quarterly Reports, our WEM reform work has had 3 main directions. The first direction is the involvement in the ongoing process of improving the functioning of the WEM in its current form (metering, payment and settlement procedures, algorithm procedure, market rules and pricing,

and governance issues). This work, which is organized through the system of WEM Board working groups is described in sections C.2. and C.3.

The second direction relates to the critical analysis of the WEM bill that was in the Verkhovna Rada process. At the end of July, the President vetoed the Law, asking the Rada to reject it as a whole, and as unsuitable for the further development of the Ukraine WEM. There were no further developments in this area during the last quarter; the Law appears to have been defeated and is not arising again.

The third direction of our WEM work has dominated since January 2002, and is our participation in and support of the WEM Concept Commission. See Annex G for a summary of the status of achievement or our technical purposes in working with the WEM Concept Commission.

C.6.2. 8th Quarter Developments

Intense work continued during the 8th quarter. Based on the approved 'Problem Table' and 'Outline of the Concept', the Working group prepared and discussed papers on the following issues:

- Analysis of the current functioning of the WEM
- World Experience in power market design and demands of EU legislation (in the context of harmonization of Ukrainian energy legislation with EU legislation)
- Aims of WEM reform and principles of WEM functioning
- Strategic Directions for the development of the Ukraine WEM
- Tasks and measures to overcome the problems of the current WEM.

As expected, the Hunton & Williams team has devote large resources and knowledge transfer. We have developed and proposed numerous technical documents to the daily sessions of the WEM Concept Commission working group. We have had to do this while also assuring we remain accepted by the stakeholders that comprise the working group and the WEM Concept Commission.

This required intense prior preparation as well as ongoing work in the process. To prepare, we first conducted several internal discussions within only our own staff, designed to clarify the aims of our WEM work and the solutions. We were able to begin by use of an fully analyzed list of "problems" and solutions that we had developed over the previous year. Using this as the basis for discussion, we then prioritized our proposals in detail against our USAID contract purposes. We then allocated specific topics to specific members of the local staff. This common analytical framework allowed us to provide high quality, well researched documents to the WEM Concept Commission working group, while at the same time ensuring that the relevant member of our staff is always present during the discussions on any particular topic. As well, each member of the staff was aware of not only their own issues, but of the possible cross-implications to issues handled by others. As a result, our staff as a whole, not merely the ex-patriots, were able to effectively advocate each technical position as it arose, and to discuss them effectively with the relevant counterpart or other WEM Concept Commission working group members at each daily session. We believe the value of this approach is demonstrated by the broad success we have achieved in introducing many important technical concepts into the resulting product, as summarized by Annex G.

. The broad allocation of issues is as follows:

- Ilka Lewington – Strategic directions; Issues of increasing competition; and Financial contracts
- Vladislav Raschepkin – Metering, Grid Code, Demand limitations
- Victoria Dodonova – Governance, Export/Import, Fuel Market
- Anna Ryzhova – Removal of administrative interference; Debts
- Yelena Antonova – Tariffs and Regulation, Investment.
- Paul Ballonoff – Debts analysis; Market impact assessments; Supporting or overseeing other staff areas.

After intense discussions both within the daily working group and in the periodic (roughly, each third week) meetings of the WEM Concept Commission, a model of evolutionary development towards a

bilateral contract market was chosen as the basis for the 'Strategic directions of the development of the WEM'. The H&W team was able to influence the development of this model by pointing out flaws, gaps and inconsistencies present in early drafts. We also gave detailed descriptions and model calculations of some of the risks involved in developing a direct contract market in parallel to the existing spot market. When the decision in favor of this model was made by the Commission, it was explicitly stated that it will be reworked to include crucial parts of the H&W strategic directions model.

In parallel to the Strategic Directions, the working group developed papers dealing with the problems of current WEM operation, suggesting concrete measures to overcome them. It is often easier for the WEM Concept Commission to reach consensus on these technical papers than on the same issue in the 'strategic model' discussion. The following positive consensus results have already been approved by the WEM Concept Commission by the body acting at a scheduled meeting:

- Fuel market - recognition that fuel markets need to be created and that generators should have access to them
- Development of competition in generation and supply, as well as import export and access to the generation market
- Payment guarantees and hedging of price risks - both need to be introduced, the first made obligatory, the second optional but if introduced, then with supervision by NERC
- Full current payment – practical measures to enforce disconnection of non-paying customers
- Stop demand limitations for solvent demand - needs change in general approach, and amendment of normative documents still limiting solvent demand
- Stop administrative interference into the funds flow - it was accepted that the proportional allocation of money principle should be specified by Law.
- Export, import - it was accepted that all such operations should go through the WEM, and that there should be licensing and determination of status of exporters, importers as parties to the WEMMA, and added procedures in the WEMMA.

Most of these issue papers were written and defended by H&W staff. See Annex G for a detailed summary of documents prepared, and the outcome to date of critical technical issues, by topical outline of the WEM Concept Commission.

During the coming quarter, the working group and the WEM Concept Commission will finalize the Concept. Hunton & Williams will be closely involved in developing the final wordings, in preparing and conducting the public discussion, and in designing detailed implementation measures.

C.7. OTHER WORK WITH OTHER USAID PROJECTS

C.7.1. Bankruptcy Related Issues

In preparation of the "Dniproenergo" bankruptcy case analysis and drafting the letter on the GOU Draft Law, Hunton & Williams co-operated with the USAID sponsored Commercial Law Center. On 11 and 12 February we held two joint meetings and exchanged with written documents and oral ideas regarding the contents of the letter on the GOU Draft Law. Both projects agreed that the said draft law need changing and may not be passed in present version. On March 7, the Draft Law was in fact defeated at the Verkhovna Rada. See also, 5th and 6th Quarterly Reports, Section C.5.1 and the 7th Report at this section C.7.1.

D. SUPPORT OF THE PRIVATIZATION EFFORT.

D.1 OVERVIEW OF H&W PRIVATIZATION ACTIVITIES

USAID's primary privatization advisor to the State Property Fund is DTT. Hunton & Williams assists the privatization effort, within our focus of developing legal and regulatory support to prepare and sustain Ukraine's power sector for privatization. We thus work closely with DTT on several activities:

- We review, comment in detail on, and propose alternative drafts to, various instruments of the privatization process, including CabMin resolutions, tender notices, draft presidential decrees, and other materials.
- We meet with DTT, separately, and with DTT jointly with USAID, to discuss issues of privatization strategy for oblenegos and for generation companies, and have provided detailed comments on drafts of these strategies.
- We work with DTT to advise the State Property Fund on issues related to the purchase and sale agreement, and on problems of assuring performance of government (and investor) obligations through a partial risk guarantee (from the World Bank or EBRD), and on similar purely contractual devices.
- We routinely provide DTT and others in the Donor community with English-translated copies of laws and other normative acts, such as for use in its privatization web site, or for reference as issues develop.
- We work jointly with the NERC and investors to develop a NERC tariff procedure to implement the new tariff, thus to support the privatization process.
- We regularly meet with potential and actual strategic investors to explore their views and privatization participation requirements, passing relevant information to DTT and incorporating the same into our work.

D.2 IMPLEMENTATION OF CABINET OF MINISTERS RESOLUTION No.133-p

Hunton & Williams monitors implementation by government agencies of CMU Resolution No. 133-p "On the System of Arrangements to Create Favorable Conditions for the Development of Energy Sector" of 7 April 2001. Our regular updates on the status of Resolution 133-p are provided to DTT and in turn to the Donor group; see Part E.1 for more detail. However, it is our intent to advance discussion of these issues from simply reporting, to proactive participation in avoiding the risks, and/or, better defining them and thus better defining contractual means to avoid or resolve them. See therefore items E2 through E5 below.

D.3 LEGAL ANALYSIS OF WAYS TO RESOLVE INVESTOR RISKS

See discussion in Part E.2 below.

D.4 TENDER CONDITIONS IN THE UPCOMING ROUND OF PRIVATIZATION

We continue to provide detailed comments on pre-qualification criteria to DTT and the Donors as issues arise on obleneg privatization.

E. ACTIVITY FOR INTERNATIONAL PRIVATIZATION TASK FORCE AND DONOR COMMUNITY.

As previously mentioned, the GOU and the principal international donor agencies in Ukraine – EBRD, IMF, the World Bank and USAID – created an international power sector privatization Task Force to resolve problems. The decisions of the Task Force routinely shape and guide the directions of our Project. Within the Task Force, USAID plays a key role directing Task Force activities, including drafting concept papers summarizing the group consensus (or seeking to attain such consensus). The working body of the

International Task Force is the weekly “Donor Meeting”, in which Hunton & Williams is a normal participant. Hunton & Williams regularly assists in preparation of Task Force documents and reports to the Donor Meeting on matters in its areas of competence.

E.1. PARTIAL RISK GUARANTEE: ALTERNATIVE SCHEME OF ITS APPLICATION

The Hunton & Williams Project Office held a number of discussions with the EBRD representatives on the possibility to remove legal constraints in implementation of the partial risk guarantee. The Project developed an alternative scheme of partial risk guarantee application. There were also researched the legal differences between the guarantee applied in Sea Launch Project and the partial risk guarantee developed by the EBRD for the purposes of securing the risks of the investors in up-coming privatization. Unfortunately, the Government of Ukraine has rejected this instrument, and, thus, the issue of alternative investor risk reduction plan became relevant.

E.2. ALTERNATIVE INVESTOR RISK REDUCTION PLAN

The Hunton & Williams Project Office developed and has presented to the USAID a Alternative Investor Risk Reduction Plan, consisting of two sections. Section 1 addresses the general issues to be resolved by the Cabinet of Ministers in order to create favorable investment environment in the up-coming privatization, such as: WEM reform, land title and inventory of land plots, environmental liability, VAT deduction from commercial losses, exclusivity of licenses of electricity supply companies, debt restructuring agreements, and assuring the general meetings of energy company shareholders.

Section 2 of the Plan points to the need to improve the purchase and sale agreement. The Hunton & Williams Kiev Project Office proposed that the purchase and sale agreements implement the concept of cross obligations of the parties. The cross obligations should be separated in the contract from transactional obligations of the parties and should regulate the fulfillment by investors and the Government of Ukraine of obligations undertaken in respect of operation of companies. The implementation of the concept of cross obligations requires that the Cabinet of Ministers of Ukraine issues a resolution, by means of which it undertakes the state cross obligations such as non-interference in cut-off, timely and due payments for privileges and subsidies and for electricity consumed by the budgetary organizations. By means of the same resolution, it should amend its own acts contradicting state cross obligations (for instance, canceling the CMU resolutions envisaging prohibition to cut-off entities enjoying the so-called “emergency reserve”) and also provides effective mechanisms by means of which the potential indebtedness of the state budget to oblenergos can be settled (for example, mutual offset of payments due from budget and tax payments due to the budget, other mechanisms). Finally, the resolution should clearly express an instruction to the State Property Fund to include in the purchase and sale agreement those state cross obligations undertaken by the CMU, including mechanisms by which they will be carried out. The SPF can then properly include the provisions of the CMU Resolution to the purchase and sale agreements. Disputes arising from the cross obligations of the parties should be subjected to the jurisdiction of the International Center for Settlement of Investment Disputes.

The implementation of the Alternative Plan to a great extent will depend on the political will of the CMU to undertake state cross obligations and elaborate effective mechanisms. The Donor community, potential investors, the SCFB and the SPF should take joint efforts to persuade the CMU to undertake state cross obligations and to negotiate mechanisms. Therefore, there should be created a Working Group (“WG”), which will develop provisions of the CMU Resolution. It should consist of the representatives from the Donor community, the SPF and the SCFB. The potential investors should be allowed to attend the sessions of the WG occasionally. The SPF and the SCFB should be the main promoters to the CMU of the results achieved by the WG.

E.3. NEW LAND CODE REQUIREMENTS FOR PRIVATIZATION

The Hunton & Williams Kiev Project Office informed the Donor Community on the requirements of the new Land Code of Ukraine on private companies having land plots in permanent use, to obtain ownership rights or conclude land lease contracts for those plots prior to January 2005, i.e. within three years. Once electricity supply companies are privatized, these requirement will reach them as well. To comply the electricity supply companies will have to (1) conduct a land inventory; (2) determine which of the land plots they currently use they prefer to own, to lease or to use under the right of landed servitude; (3) apply to the owners of these land plots with relevant requests; (4) enter in purchase and lease contracts, and receive land deeds for plots they purchased and state acts of registration of rights of landed servitude. It is important that the issue of financing the conduct of land inventory and obtaining land deeds is resolved prior to the sale of electricity supply companies. Therefore, the NERC should in the nearest future allow companies subject to privatization to reimburse these expenses from the tariff.

E.4. INFLUENCE ON PRIVATIZATION OF VAT DEDUCTION FROM COMMERCIAL LOSSES

Due to changes in tax legislation introduced by the Law of Ukraine “On Introduction of Amendments to Article 11 of the Law of Ukraine “On the Value Added Tax”, July 11, 2001, No. 2649-III, the electricity supply companies deduct VAT from supply and transmission tariffs before customers make payments for electricity (except for electricity supplied to budgetary organizations). Thus, VAT is charged based on the accrual method. Since the tariff for electricity transmission covers commercial losses, the accrual method of VAT deduction makes the value of such losses subject to VAT deduction as well. The rate applied currently to adjust the transmission tariff for commercial losses is 7% of the volumes distributed by local networks. If commercial losses of an electricity supply company exceed 7%, the company suffers damages not only for the excessive losses, not covered by the tariff, but also for the VAT charged on value of such losses. The companies subject to privatization currently suffer large commercial losses, on which they also thus must pay a VAT. The NERC has no authority to resolve this issue. Hunton & Williams has discussed with the Donors the policy issues involved in the choice of changing this VAT tax treatment, since, while removing the fee on losses would reduce expenses of oblenegros, it would also reduce their incentive to more rapidly reduce losses from non metered “sales”.

E.5. PROHIBITION TO CUT-OFF WATER-SUPPLY COMPANIES

The Hunton & Williams Project Office informed the Donor Community on the prohibition of the Law of Ukraine “On Drinking-Water and Drinking-Water Supply” No. 2918-III of January 10, 2002 to disconnect “objects” of drinking-water supply and wastewater drainage from systems of electricity, gas and heat supply. The Project upon approval of the Donor Community prepared for the Task Force meeting a brief review of the problem and recommendation to Government of Ukraine, that is to create a mechanism of payments for electricity consumed by water utilities-debtors. The following instruments were proposed as examples of such mechanisms: (1) deduct the indebtedness of water utilities-debtors in computing full payments by electricity supply companies of electricity purchased from SE “Energorynok”; (2) reflect factual electricity costs in water tariffs; (3) the possibility that electricity supply companies might manage water utilities-debtors.

E.6. WEM CONCEPT COMMISSION REPRESENTATION

Hunton & Williams’ market economist Ilka Lewington was nominated by the Donor group as their representative on the WEM Concept Commission. In addition to Ilka Lewington’s work on behalf of the Donors, two of our local staff attorneys (Victoria Dodonova and Anna Ryzhova) have worked full time on Concept Commission and WEM Working Group activities, and Hunton & Williams has also assigned a full time staff to manage the Concept Commission Secretariat work. Details of the WEM Concept Commission are discussed at Part C.6, Annex E and Annex G..

F. TRAINING AND STUDY TOUR PROGRAM

Hunton & Williams has developed a focused training program to support Project objectives. Rather than the traditional training consisting of courses and lectures, we devised a series of week-long training programs. Each program typically consists of a one day traditional lecture by a consultant in a particular area, followed by four days of hands on training and discussion with each of our GOU counterpart agencies. The purpose of the exercise is to impart a common vocabulary and to discuss a common set of issues among the counterparts. The topics are selected to emphasize particular aspects of our substantive program: regulatory law, basics of regulation, tariffs and rate design, power pools and generation pricing. The actual design of delivery varies by the topics presented and the counterparts to whom directed.

F.1 STUDY TOURS AND COUNTERPART TRAVEL SPONSORED BY H&W

(Discussion moved from Part G.2). There was no counterpart travel to conferences or study tours sponsored by Hunton and Williams in the 8th Quarter.

F.2. PLANNED TRAINING IN FUTURE QUARTERS

In the next Quarter Hunton & Williams intends to hold a number of training courses requested by NERC.

F.2.1. Regulatory Capital Structures Course

Training in Regulatory Capital Structure is planned for later in 2002. Our intention is to invite current or former FERC staff experts to deliver this course and cover the following issues:

- Interest cost, equity cost for ownership capital, how to measure what it should be,
- Why the regulator cares about return on equity, cost of debt, and total cost of capital
- The weighted average cost of capital; how to compute it, and what uses it has to the operator of the utility, and what concerns it causes the regulator,
- Doctrines of regulatory rate base, especially “used and useful”. Why the regulatory rate base may be and usually is different from the total capital derived from all sources of capital.

F.2.2. European Integration Training Advisory

The proposed NERC Law has been classified by the Verkhovna Rada as, in part, an issue of European Integration. As well, aspects of the Wholesale Energy Market design (concept) are also affected by European integration (EC Energy Directive) issues. In May 2002 Steve Horvath, the Managing Partner in charge of the Hunton & Williams UK office worked with the NERC to help develop a draft law. We expect that he will return in September or October for a 3 days training- advisory on European Integration issues, especially regulatory transparency. Steve Horvath has previously worked with this project presenting talks and seminars on regulatory independence and WEM market design, on behalf of the FEC Committee.

F.2.4. Regulatory Procedures Course.

Training for the NERC in FERC Procedures, and Regulations has been scheduled for early summer 2002, to be delivered by FERC senior attorney Bill Froehlich, who has previously delivered two other courses for this Project in Ukraine, and for other USAID projects in this region.

F.3. TRAINING IN 8th QUARTER

F.3.1 Time of Use Rates Course

Training in Time of Use Tariifs was delivered by NERA (Andrej Juris) and covered the following major issues:

- Economic reasons for application of TOU rates at the wholesale energy market and for ultimate customers,

- Types of TOU rates applied in the wholesale market and for ultimate customers (hourly, seasonal). Relation to availability of generation capacity,
- Market structure preconditions that have to be observed in application of the TOU rates,
- Examples of how TOU rates are applied under different market structures that have different pricing.

The representatives of the NERC pricing, energomarket, technical departments, the representatives of Mintopenergo, NEC Ukrenergog as well as the staff of oblenergog attended five morning group sessions. In the afternoons Mr. Juris individually met with the NERC Commissioner Mr. Kotko, Head of the NERC pricing department to discuss the problems of the Ukrainian approach to setting the time of use rates. An individual meeting was held with the Chairman and staff of NERC energomarket department. A wide range of issues related to WEM functioning was discussed at this meeting.

Mr. Juris met with the representatives of the Fuel and Energy Committee of the Verchovna Rada to follow up on the analysis of the Energy Policy Law, which was done by NERA in 2001. Mr. Juris also held an internal seminar for the staff of Hunton & Williams where he reviewed the experience of preparation of Slovakian power distribution companies to privatization, in particular the distribution tariff methodology

G. CBM, FUELS RESEARCH AND OTHER ACTIVITIES

G.1 OIL AND GAS ACTIVITIES

Hunton and Williams had no oil and gas activities in the 8th Quarter.

G.2. CBM SUPPORT PROJECT AND OTHER FUELS RESEARCH.

G.2.1 Regulation Of Generating Company Fuel Purchase And Fuel Use.

Genco inability to decide independently on how much, when, from whom and what fuel to purchase, is caused by government interference into the energy and fuel sector. Based on research on these topics recorded in our previous Quarterly Reports, we made one of our goals for the WEM Concept to assure opening of fuels markets for generating companies. See Annex G for current status of that goal.

Also a result of related research on quantitative (physical and financial) impacts of fuel use decisions, on March 5 2002 Hunton & Williams Kiev presented results to the USAID staff, and on their recommendation, made a second presentation to the staff of the US Embassy on March 23 2002. (The slides for that presentation are attached here as Annex K). In the last week of May 2002 the US Embassy relied heavily on our research for a speech delivered by the US Ambassador, entitled "Energy Market Reform In Ukraine" May 22, 2002 Remarks by U.S. Ambassador Carlos Pascual to the Ukraine: Energy Hub of Europe, Second International Oil and Gas Conference: Energy Forum Ukraine - 2002

G.2.2 Analysis of the State Material Reserve.

No additional research on this topic in the 8th Quarter.

G.2.3 Structure Of Ukrainian Fuel Market.

No additional research on this topic in 8th Quarter.

G.2.4 Limitations on Energy Purchases

On 9 April 2002, the Cabinet of Ministers issued a revised Resolution 441 (the Resolution 475), improving situation with the constraints on the ability of the Ukrenergo dispatch center to meet in full the demand of any oblenargo which pays 100% for previous power purchases. It was an active goal of Hunton & Williams to obtain such resolution. The main achievement of the Resolution 475 is to remove the clause stating that purchases of any region (several oblenergos), including those who pay 100% cash to the market, could be limited if the overall fuel balance in the country is poor. However, the role of Minenergo to set the level of regional limitations is retained in the new Resolution. Another positive change in the new Resolution is that consumption of budget organizations providing communal services is limited to the means allocated to them from the state budget. Previously Resolution 441 prohibited restricting consumption of electricity by these organizations due to lack of funds. Resolution 475 still prohibits limiting consumption of electricity by households and the armed forces. Hunton & Williams has prepared proposals for inclusion removing these remaining problems in the WEM Concept, discussed separately in this 8th Quarter Report.

G.2.5. Government Legal Ability to Affect Thermal Genco Privatization.

No additional research on this in Quarter 8.

G.2.6. CBM Experience Survey and Conference

Consistent with the written request from Project CTO we have organized a survey of interested entities in the experience of CBM development in Ukraine to date. By the end of May we had circulated ___ surveys by mail, fax and e-mail, done telephone follow up to obtain responses, and have received 7 replies. Six are from operating companies who considered investing in Ukraine but did not, and one from the United States Environmental Protection agency. We are analyzing the responses and expect to make a recommendation regarding a conference to USAID in early June. Since many of the respondents specifically asked about sources of CBM project financing, we have also researched such possible sources from United States institutions, international Donor organizations, and international financial institutions, and will attach this report to our recommendation.

G.2.7. Project Web Site.

Hunton & Williams Kiev Project Office has developed a project website. The site presents information about the purposes of the Ukraine Energy Regulatory, Legal and Market Development Support and Coalbed Methane Support Projects; it provides contact information of the Kiev project office; it describes project activities and principal products; it offers information on training and conferences sponsored, organized and participated by H&W project staff; and it lists useful links to energy and legislation resources. The website is under construction and will be eventually posted in three languages (English, Ukrainian and Russian). The website URL is: <http://www.hunton.kiev.ua/eng/index.shtml>

PART H: REGISTER OF MAIN PROJECT ACTIVITIES: MARCH 1, 2002 to MAY 31, 2002

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
				Date	Title	Participants
				H. Participation in the weekly Donor Community meetings I. and J. bimonthly International Task-Force meeting		
	H.				I. Tariffs	
	<ul style="list-style-type: none"> Research of the regulatory accounting practices in UK 	13-18 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Analysis of the recent draft procedure for the review of the nuclear generators' tariff 	14 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Review of the high voltage transmission charging theory 	19 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Input into the "Strategic Directions for WEM Development" 	25-26 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Research of Ukraine average tariffs for 2000 and 2001 	28 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Memo on the impacts of expiration of the Cabinet of Ministers resolution # 45 on cash distribution at the WEM 	2-11 April, 2002	Y. Antonova	8 April, 2002	ESE WG on the upper algorithm	Y. Antonova
	<ul style="list-style-type: none"> Review of the Electricity User's Code 	12-22 April-10 May, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Research on the info related to the WEM Market Banker 	23 March, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Assistance to NERC in reviewing Zakarpattiaoblenergo tariff filing 	13 May, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Review of the draft procedure on other than licensed services 	17 May, 2002	Y. Antonova		J.	
	<ul style="list-style-type: none"> Assistance to US Embassy in preparation of the Ambassador's speech on generation issues; Review of current practices for inclusion of the investment component in the WEM price 	20-21 May, 2002	Y. Antonova			

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Preparation of NERC's pricing department's input into the WEM Concept on the issues of tariff and investment policy in the energy sector 	27-28 May, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Assistance to the NERC in assessing the impact of potential tariff increases for 9 oblenergos to be privatized 	29-31 May, 2002	Y. Antonova			
					Regulatory issues	
	<ul style="list-style-type: none"> Research and report on draft amendments to the EU Electricity Directive 96/92 which sets up independence of the regulatory agencies of the State governments 	29 April-7 May, 2002	L. Surzhenko			
					Improvement of current WEM	
	<ul style="list-style-type: none"> Comparative analysis of the fuel prices in Ukrainian internal fuel market and the other fuel markets 	1 March, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Revision of the general structure of the fuel supplies to gencos 	1 March, 2002	A. Ostrovskaya			
	<ul style="list-style-type: none"> Description of the structure of model of the economic dispatch of the thermal power plants 	4 March, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Memo on oblenergo's protection from the customers' suits 	5 March, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Report on the WEM Board meeting 	12 March, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Study on the fuel prices issues, comparative analysis of the assumption on fuel prices for the modeling purposes 	12 March, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Report on the WG meeting on review of the WEM Members' Agreement provisions concerning division of proportional votes. 	15 March, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Comparison of the input data for fuel prices used in different models of Ukrainian power sector 	15 March, 2002	V. Raschepkin			

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	• Analysis of the condition of the equipment of Ukrainian TPP from the point of the results of Turbo C++ modeling	19 March, 2002	V. Raschepkin			
	• Memo on the market share limitations imposed by NERC	19 March, 2002	L. Surzhenko			
	• Summary on presumed actions in order to open the fuel market for the free access by suppliers and generating companies	19 March, 2002	A. Ostrovskaya	K.		
	• Review of market share limits in the NERC License for electricity generation	20 March, 2002	L. Surzhenko	L.		
	• Review of the international experience concerning Dispatcher's voting rights	20 March, 2002	L. Surzhenko			
	• Memo on financial contracts in electricity markets	27 March, 2002	V. Raschepkin	M.		
	• Summary on the CMU Order #45-p	26-27 March, 2002	L. Surzhenko			
	• Description of the economic dispatch of the thermal power units in Ukraine	28 March, 2002	V. Raschepkin	28 March, 2002, 5 April, 2002 15 May, 2002 30 May, 2002	WEM Board meetings attendance	V. Raschepkin, V. Dodonova, I. Lewington
	• Study on the cost structure in the coal industry in Ukrainian fuel market	1 April 2002	V. Raschepkin			
	• Other draft memo on oblenergo's protection from the customers' suits	1-2 April, 2002	L. Surzhenko	N.		
	• Memo on cutting off procedure stated in the NERC Electricity Use Code	3-10 April, 2002	L. Surzhenko			
	• Report on the voting for changes to the WEM "upper algorithm" at the WEM Board meeting	April 3, 2002	V. Raschepkin			
	• Data on the local prices and coal production costs in Ukrainian fuel market	8 April, 2002	V. Raschepkin			

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Analysis of the capacity payments to the generators in the UWEM Description of the energy sector model 	16 April, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Memo on the capacity payment, and pricing of the thermal generators in the UWEM 	18 April, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Calculations on the mechanisms of the financial contracts 	19 April, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Research on the competition in the electricity markets and possible abuse of market power 	23 April, 2002	V. Raschepkin			
	<ul style="list-style-type: none"> Memo on the development of the competition in a wholesale electricity market 	30 April-8 May, 2002	V. Raschepkin		O.	
	<ul style="list-style-type: none"> Comparative table of cutting off procedure stated in the EUC and draft EUC 	10-13 May, 2002	L. Surzhenko		P.	
	<ul style="list-style-type: none"> Scenarios for direct contracts in the electricity markets of Ukraine 	17 May, 2002	V. Raschepkin		Q.	
	<ul style="list-style-type: none"> Modeling of the ESE option of UWEM development in the part of volumes of allowed direct contracts with generators 	20-24 May, 2002	V. Raschepkin		R.	
	<ul style="list-style-type: none"> Data on price dynamics in the reformed electricity markets 	21-22 May, 2002	V. Raschepkin		S.	
	<ul style="list-style-type: none"> Memo on determination of the oblenergo's territory where it carries out its licensed activities 				T.	
	<ul style="list-style-type: none"> Study on the price behaviour in restructured electricity market 	31 May, 2002	V. Raschepkin		U.	
	V.				W. WEM Law and WEM reform	

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Energy Markets World experience 	1-5 March, 2002	A. Ryzhova, V. Dodonova		<ul style="list-style-type: none"> WEM Concept sub-group participation; WEM Concept Interagency Committee participation 	I. Lewington, V.Dodonova, A.Ryzhova, Y. Belonozhko, V. Raschepkin, I. Lewington, V. Dodonova, A.Ryzhova
	<ul style="list-style-type: none"> Section 5 to the WEM Concept 	25 March, 2002	A. Ryzhova	1-8 March, 2002	<ul style="list-style-type: none"> Organizational, legal and economic bases of current WEM functioning; objectives and tasks of WEM Concept structure; problem of current WEM model 	See above
	<ul style="list-style-type: none"> Column 2 of the WEM strategic directions 	25 March, 2002	V. Dodonova	X. Y. 11-15 March, 2002	<ul style="list-style-type: none"> Approval of WEM current situation analysis; discussion and approval of EU requirements in energy sector and harmonization of Ukrainian legislation with these requirements; discussion and approval of Energy Markets World Experience prepared by H&W and to be submitted to Interagency Committee 	See above
	<ul style="list-style-type: none"> H&W WEM model (phase 1 and 2) 	1-5 April, 2002	A. Ryzhova, V. Dodonova	21 March, 2002	<ul style="list-style-type: none"> Interagency Committee seating; Introduction of amendments proposed by the Committee members 	See above
	<ul style="list-style-type: none"> Research and analysis of the legal issues related to voting procedure under WEMMA 	12 April, 2002	V. Dodonova	27 March, 2002	<ul style="list-style-type: none"> Summary of the instructions/recommendations of the Interagency Committee 	See above
	<ul style="list-style-type: none"> Research on European integration related to transit issues 	12 April, 2002	V. Dodonova	28 March, 2002	<ul style="list-style-type: none"> Discussion of the strategic directions of WEM 	See above
	<ul style="list-style-type: none"> Analysis of EU Directive 90/547 Summary on 6.2.10 of WEM Concept structure 	16 April, 2002	V. Dodonova	1-5 April, 2002	<ul style="list-style-type: none"> Discussion of INECO and ESE WEM model 	See above

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Draft “Measures against limitation of solvent demand” 	16 April, 2002	A. Ryzhova	8-10 April, 2002	<ul style="list-style-type: none"> Presentation of H&W WEM model (phase 1 and 2); discussion of system of limitations and network losses under the documents prepared by NEC “Ukrenergo” 	See above
	<ul style="list-style-type: none"> Research changes in law necessary to implement H&W new design and world experience in Market Operator organizing 	24 April, 2002	A. Ryzhova	11 April, 2002	Interagency Committee seating <ul style="list-style-type: none"> Presentation of Energy Markets World Experience and WEM Strategic directions 	I.Lewington, V. Dodonova, A. Ryzhova
	<ul style="list-style-type: none"> List of changes necessary to be introduced into the laws of Ukraine and other normative acts to implement the proposed WEM model 	24 April, 2002	V. Dodonova	12 April, 2002	<ul style="list-style-type: none"> Discussion of network losses problem and possible solutions 	See above
	<ul style="list-style-type: none"> Research and analysis of international experience in respect of the legal form of Market Operator 	25 April, 2002	V. Dodonova	15-19 April, 2002	<ul style="list-style-type: none"> Discussion of WEM debt restructuring: possible solutions; Discussion of measures to ensure full current payments for electricity; financial contracts on energy market Approval of Measures against limitation of solvent demand Discussion of measures on tax liberalization for energy companies Discussion of issues related to risk hedging, system of limitations 	See above
	<ul style="list-style-type: none"> Research and analysis of the international experience related to Market Operator status and functions 	25 April, 2002	A. Ryzhova	22-26 April, 2002	<ul style="list-style-type: none"> Discussion of H&W comments to WEM design; Discussion of issues related to import/export/transit 	See above

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Research of Market Operator status and functions under international and Ukrainian law 	26 April, 2002	A. Ryzhova	6-11 May, 2002	<ul style="list-style-type: none"> Discussion of H&W WEM model elaboration; Discussion of ESE WEM model elaboration Discussion of World Energy Markets analysis Discussion of legal issues related to CJSC 	See above
	<ul style="list-style-type: none"> Research and analysis of the legal issues related to Market Operator in the form of CJSC 	26 April, 2002	V. Dodonova	16 May, 2002	Interagency Committee seating <ul style="list-style-type: none"> Elaboration of H&W, ESE and Mintopenergo WEM Models; World Energy Markets 	See above
	<ul style="list-style-type: none"> Analysis of World Energy Markets 	6-11 May, 2002	A. Ryzhova	20-24 May, 2002	<ul style="list-style-type: none"> Preparation of the Concept documents on state regulation (Concept of Licensing of Energy Entities) Preparation of the Concept documents on Administrative Interference into the WEM Representation and discussion of H&W document on Administrative Interference into the WEM. Summarizing of Mintopenergo debt restructuring Concept Discussion of issues related to competition at WEM Discussion of export/import issues, capital construction 	See above
	<ul style="list-style-type: none"> Research on issues regarding Polish experience (single buyer) 	16 –20 May, 2002	V. Dodonova	27-31 May, 2002	<ul style="list-style-type: none"> Discussion of administrative interference Discussion of criteria of comparison of the proposed models Finalizing issues related to export/import, insurance and other 	See above

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Preparation of the paper on “Favorable Conditions for Construction and modernization of Energy Sector Assets” Input on Investment issues for the WEM Concept group 	21 May, 2002	Y. Antonova			
					Laws and related issues	
	<ul style="list-style-type: none"> Analysis of the new Draft Electricity Use Code 	8-9 April, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Analysis of EU Directives and local legislation related to the EU Directives requirements 	15 April, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Research on the compliance of Ukrainian energy law with EU Directives regarding the distribution system operation 	18 April, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> Research on legal issues related to CJSC 	6 May, 2002	V. Dodonova			
	<ul style="list-style-type: none"> Study and comments on new NERC draft law 	14-24 May, 2002	A. Ryzhova, K. Mokanu			
	<ul style="list-style-type: none"> Analysis of the Draft NERC Law prepared by NERC Preparation and translation of the specific language of the comments to the Draft NERC Law Additional comments to the licensing provisions of the Draft NERC Law 	13-31 May, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Comments to the draft NERC Law 	24 May, 2002	Y. Antonova			
	<ul style="list-style-type: none"> Debt Restructuring Law statutory analysis 	27-31 May, 2002	A. Ryzhova			
					Direct Privatization support	
	<ul style="list-style-type: none"> Memo on PSA requirement to investor on the number of employees 	1-4 March, 2002	K. Mokanu			
	<ul style="list-style-type: none"> Comments on the PRG application 	5-11 March, 2002	K. Mokanu			
	<ul style="list-style-type: none"> Alternative scheme of PRG application 	12-13 March, 2002	K. Mokanu			
	<ul style="list-style-type: none"> Research of application of Oblenergo Support Agreement 	14-15 March, 2002	K. Mokanu			
	<ul style="list-style-type: none"> Tables on OSA and Project support agreement 	21 March, 2002	K. Mokanu			

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	• Memo on Emergency reserve and hazardous objects	22-27 March, 2002	K. Mokanu			
	• Research on VAT under CMU instruction #105-p	28 March, 2002	K. Mokanu			
	• Memo on the choice of law in PSA, OSA, PRG	29 March 2002	K. Mokanu			
	• Memo on authority of state bodies over genco's privatization	29 March, 2002	A. Ostrovskaya			
	• Research on prohibition to disconnect water supply	2-3 April, 2002	K. Mokanu			
	• Memo on emergency reserve	4-5 April, 2002	K. Mokanu			
	• Research on deduction of VAT from commercial loses	8-9 April, 2002	K. Mokanu			
	• Tables on EU integration	10-11 April, 2002	K. Mokanu			
	• Memo on new Land Code requirements	12-15 April, 2002	K. Mokanu			
	• Memo on EU integration	22-26 April, 2002	K. Mokanu			
	• Memo on Investment Component Taxation	7-10 May, 2002	K. Mokanu			
	• Analysis of the debt restructuring concept	15-16 May, 2002	K. Mokanu			
	• Analysis of cut off policy in draft NERC Law	27-28 May, 2002	K. Mokanu			
	• Analysis of Debt Restructuring Law	30-31 May, 2002	K. Mokanu			
	•				IT	
	• Participation in ESE IT WG meeting: reports on the meeting	24 May, 2002	I. Papazova, V. Raschepkin	8 April, 2002	Second equipment supply for the NERC	I. Papazova
					Study Tours, Conferences, Overviews of international practice and Training	
	• Briefing to the US Embassy and USAID. Comparative Analysis of Ukraine Thermal Power Generation	29 March 2002	P. Ballonoff, I. Lewington			
	• TOU Rates Course (training on differentiated tariffs for the NERC specialists lectured by Andrej Juris, NERA)	15 -19 April, 2002	NERC specialists	Z.		
	• 1 st Energy Regulatory and Investment Conference in Budapest, Hungary	24-26 April, 2002	Y. Antonova, L. Surzhenko			

	Subject of the paper	Date	Author of document	Working Groups participation and other activities		
	<ul style="list-style-type: none"> Support to the NERC in participation in the WEM Concept group by I. Adams 	13-17 May, 2002				
	<ul style="list-style-type: none"> CISCO Training for specialists of ESE 	The course is scheduled in four semesters and will last till 30.09.2002				

PART I: NERC ACTIVITY REGISTER MARCH 1, 2002 to MAY 31, 2002

#	Subject of the request / activity	Date of receiving the request	Form	Request / activity originated by	H&W disposition to the request	Status	Notes/ Importance
48	Request to translate the invitation for Mrs. Lagoduyk to "Energy and Gas 2002" Conference to be held on April 19-22 in Brussels and to "Renewable Energy Opportunities" Conference to be held on April 22-24 in London.	March, 4	Orally	Mrs. Lagoduyk, head of Pricing Policy Dpt		Ukrainian translation has been provided. E-mail response on behalf of Mrs. Lagoduyk has been sent to the organizers of the Conference (including the request to assist with funding opportunities).	
49	Request Invitation for Mrs. Lagodyuk to participate in "Insurance – Implications for the Oil & Gas Industry" Conference, to be held 21st- 22 nd May, 2002 at One Whitehall Place, London	AA. March, 13	Orally	Mrs. Lagoduyk, head of Pricing Policy Dpt		Ukrainian translation has been provided. E-mail response on behalf of Mrs. Lagoduyk has been sent to the organizers of the Conference (including the request to assist with funding opportunities).	
50	<u>Request to provide information on the world experience and to assist in elaboration of provisions on investment component of the wholesale electricity tariff of Ukraine.</u>	April, 3	NERC Letter	S.B. Vyshynsky, head of Energorynok Dpt.		On April 26 provided Mr. Vyshynsky and Mr. Lyasoviy with a Memo on requested issue. This memo was prepared by Paul B.	
51	Follow up to earlier NERC request regarding time-of-use tariffs seminar, providing List of participants, involving Minpalivenergo, NEC Ukrenergo, Energorynok SE, oblenergos etc.	April, 9	NERC Letter	Energorynok Dpt.		Seminar on time-of-use tariffs organized by H&W and conducted by NERA (National Economic Research Agency) expert for all the interested NERC people and other participants, as requested by NERC, from April 15 to 19.	
52	NERC questions, following up H&W earlier note to the Chairman	April, 15	Orally	Energorynok Dpt.		Paul responded with e-mail: general work sheet, showing how	

#	Subject of the request / activity	Date of receiving the request	Form	Request / activity originated by	H&W disposition to the request	Status	Notes/ Importance
	<p>Prodan on recovery of debt, including:</p> <p><u>(5) authorize a special cost component in the WEM fees, to be paid to Generators and market for repayment of that portion of their debt to fuel suppliers that resulted from the currency devaluation of 1998/1999 – which is the cost that was not previously charged to any customers;</u></p> <p><u>(6) request the NERC investigate the relationship between the level of capacity-availability fees paid for generation and the ability of generators to pay off remaining debts, and adjust the capacity fee as appropriate, consistent with good economic pricing practices.</u></p>					one could implement the two ideas NERC asked H&W to discuss further. Ukrainian translation of Paul's message was delivered to Energorynok Dpt on April, 15	
53	<u>Request for comments / assistance in introduction of changes and amendments to the NERC Regulations.</u>	April 16	Orally	NERC Legal Dpt		Memo prepared by L.Surzhenko was provided to NERC Legal Dpt. This Memo lays out the flaws of NERC Regulations with regard to introduction of changes to the WEM Algorithm.	
54	<p><u>Request to respond to the following questions based on Ukrainian legislation:</u></p> <p><u>1) What organizational legal structure of the Insurance companies is allowed by Ukrainian legislation.</u></p>	April 16	Orally	Commissioner Goncharova		Memo "Requirements of Creating Insurance Company" prepared by L.Surzhenko was provided to Commissioner Goncharova	

#	Subject of the request / activity	Date of receiving the request	Form	Request / activity originated by	H&W disposition to the request	Status	Notes/ Importance
	<u>2) Whether Insurance company has the right to carry out other activities.</u> <u>3) Who can create insurance company.</u>						
55	<u>Request to provide comments and input to the new NERC Bill and invitation to participate in the NERC Bill Working Group</u>	May 16	Meeting with Paul B. and Walter Hall (USAID)	Commissioner Goncharova,		On May 24 provided with H&W comments to the new NERC Bill in form of a Table.	
56	<u>Request to provide comments and input to the new NERC Bill and invitation to participate in the NERC Bill Working Group</u>	May 21, 22	Meeting with Paul B. and Steve Horwath	Commissioner Goncharova, NERC Legal Dpt, NERC Licensing Dpt		On May 31 provided with H&W proposal to Article 12 of the NERC Bill and a Memo prepared by Steve Horwath "EU ACCESSION REQUIREMENTS FOR COMPLIANCE WITH THE ELECTRICITY DIRECTIVE ON ESTABLISHING THE INTENRAL MARKET IN ELECTRICITY"	
57	<u>Participation in WEM Concept Working Group and WEM Concept Commission meetings</u>	On-going				BB. On-going	

ANNEX A
DOCUMENTS TRANSLATED
AT HUNTON & WILLIAMS NERC OFFICE
MARCH 2002 – MAY 2002

Summarizes 29 Documents Translated

DATE	NAME OF THE DOCUMENT	AVAILABLE IN EN AND / OR UKR
11 March 2002	Conclusions from looking at worldwide experience of wholesale electricity markets	English & Ukr
12 March 2002	Problems 1& 4 of proposed revision of the “List of WEM Problems” elaborated by the Task Force on WEM Concept	English & Ukr
13 March 2002	Invitation for Mrs Lagodyuk to participate in “Insurance - Implications for the Oil & Gas Industry” Conference, to be held 21st- 22nd May, 2002 at One Whitehall Place, London	English & Ukr
14 March 2002	Letter-response from the organizers of the above Conference to Mrs. Lagodyuk regarding funding opportunities	English & Ukr
15 March 2002	Document on the World Experience prepared by Mrs. Boyko for the Multi – Agency Task Force	English & Ukr
26 March 2002	WEM Problems / Relevant Measures of Their Solution, Prioritized According to Hunton & Williams Project Objectives	English & Ukr
3 April 2002	Request from S.Vyshynsky, Head of NERC Department on SE “Energorynok”	English
10 April 2002	PRESENTATION SUMMARY OF H&W PHASE I PROPOSAL for Inter-Agency Commission on WEM Concept meeting	English & Ukr
12 April 2002	NERC letter, providing the list of participants for April 15-19 Seminar	English
12 April 2002	Directions of further development of the WEM of Ukraine – Phase 1The Full Pool Model –table for Commissioner Kotko	English & Ukr
15 April 2002	SAMPLE CALCULATIONS FOR DEBT RECOVERY IDEAS	English & Ukr
16 April 2002	INEKO’s proposal to item 6.2.4. of the WEM Concept: “Creation of mechanisms for hedging risks at the wholesale electricity market, including financial ones”.	English & Ukr
17 April 2002	INEKO's paper "Answers to questions raised at April 5, 2002 meeting of the International Donors Group on issues of power sector reform"	English & Ukr
22 April 2002	WEM Concept Commission – Summary for International Task Force Meeting	English & Ukr
22 April 2002	Summary on indirect method of due tax amounts deduction	English & Ukr
23 April 2002	Elaboration of proposals concerning Phase 1 of market development under the “Full Pool Model with proportional sales” (items 3-5)	English & Ukr
24 April 2002	Draft Concept of Recovery of Losses Related to breakdown of transmission lines and transformer Equipment caused by natural calamity and technogenic catastrophe	English
26 April 2002	APPENDIX 1 – Monitoring of SMP and Bidding behavior by the regulator	English & Ukr
29 April 2002	Recent version of the Draft Concept of Recovery of Losses Related to breakdown of transmission lines and transformer Equipment caused by natural calamity and technogenic catastrophe	English

DATE	NAME OF THE DOCUMENT	AVAILABLE IN EN AND / OR UKR
30 April 2002	Experiences with power markets – overview of selected countries	English & Ukr
7 May 2002	Section 2 of NERC Resolution No. 861 dated August 18, 2000	English & Ukr
8 May 2002	Ilka's message for Mrs Boyko/WG regarding ESE model versus H&W model	English & Ukr
8 May 2002	Experiences with power markets – overview of selected countries (Part 3)	English & Ukr
13-14 May 2002	Recent version of CMU Resolution 441	English & Ukr
15 May 2002	NERC Resolution # 861 "PROCEDURE FOR DETERMINATION OF FUNDS ALLOCATION TO CURRENT ACCOUNTS OF ELECTRICITY SUPPLIERS AT REGULATED TARIFF AND TO CURRENT ACCOUNT WITH SPECIAL REGIME OF UTILIZATION OF THE WHOLESALE ELECTRICITY SUPPLIER" (section 2)	English & Ukr
17 May 2002	NERC Order #17 dated May 10, 2002 on creation of the Working Group for NERC Law	English & Ukr
21 May 2002	WEM Concept. 6.1.3. Increase of market opening and development of a competitive environment for generators and suppliers	English & Ukr
20 - 29 May 2002	EU ACCESSION REQUIREMENTS FOR COMPLIANCE WITH THE ELECTRICITY DIRECTIVE ON ESTABLISHING THE INTERNAL MARKET IN ELECTRICITY	English & Ukr
31 May 2002	Table of Comparison of new NERC Bill	English & Ukr

ANNEX B
DOCUMENTS TRANSLATED AT PROJECT MAIN OFFICE
DECEMBER 2001– FEBRUARY 2002
Summarizes 26 Documents Translated

DATE	NAME OF THE DOCUMENT	AVAILABLE IN EN AND/OR UKR
4 March 2002	Experience of the development of wholesale electricity markets (WEM) in the world.	English & Ukr
5 March 2002	Agreement with ICS on IT training	English & Ukr
6 March 2002	Conclusions from looking at worldwide experience of WEMs	English & Ukr
7 March 2002	Template of working plan for the Interdepartmental Commission	English & Ukr
11 March 2002	Conclusions from looking at worldwide experience of WEMs (Chapters 4 & 5 amended)	English & Ukr
14 March 2002	Resolution of Debt Problem (proposed by PB)	English & Ukr
15 March 2002	Positive experience and WEM operation problems	English & Ukr
20 March 2002	Action Plan of the WEM Interagency Committee	English & Ukr
21 March 2002	Structure of the document “ Concept of the operation and development of the Wholesale Electricity Market of Ukraine”	English & Ukr
22 March 2002	Problems of the operation of the Wholesale Electricity Market of Ukraine	English & Ukr
1 April 2002	Experience of the development of wholesale electricity markets (WEM) in the world (updated)	English & Ukr
3 April 2002	H&W WEM Concept Proposal	English & Ukr
8 April 2002	ESE WEM Concept Proposal	English & Ukr
9 April 2002	US Experience in Fuel Use Mandates for Electric Generators	English & Ukr
10 April 2002	Overview of European Natural Gas Markets	English & Ukr
11 April 2002	European Coal Markets	English & Ukr
16 April 2002	TOU Tariff Training Seminar	English & Ukr
17 April 2002	Summary on Deduction of VAT from Commercial Losses	English & Ukr
18 April 2002	Summaries on land Code Requirements to execute Duly Rights in Land, On Prohibition to Disconnect Objects of Drinking Water Supply	English & Ukr
19 April 2002	Debt Problem Solution, “Ineko Management” Concept	English & Ukr
22 April 2002	Elaboration of proposals concerning Phase 1 of WEM Development (with annexes)	English & Ukr
25 April 2002	International experience on accounting investment component in the electricity tariff	English & Ukr
13 May 2002	The Law on the Regulation of Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine (as proposed by NERC)	English & Ukr
17 May 2002	WEM Concept drafted by MinTopEnergO	English & Ukr
18 May 2002	Slides prepared by I. Adams for WEM Interagency Group	English & Ukr
20 May 2002	Draft CoM Resolution “On the Financing of the Projects for Completion of Construction, Reconstruction and Modernization of Energy Facilities”	English & Ukr
23 May 2002	Fuel Markets Piece WEM Concept	English & Ukr
27 May 2002	EU Accession Requirements for Compliance with Electricity Directive on the Internal Markets in Electricity Sector	English & Ukr
28 May 2002	Comparison of organizational and legal aspects of the two models	English & Ukr

ANNEX C
LETTERS SENT TO GOVERNMENT AGENCIES
DECEMBER 2001– FEBRUARY 2002

Title	Author	Signed by	Date
H& W letter to the Head of NERC Y. Prodan Re: Letter of invitation to the NERA seminar	I. Papazova	P. Ballonoff	26 March, 2002
H&W letter to the Head of the WEM Board, Chairman of the Board of “Dniproenergo” S. Popov Re: Changes in the Upper WEM Algorithm	Y. Antonova	P. Ballonoff	14 May, 2002

ANNEX D
LIST OF INTERNAL PROJECT PRODUCTS
DECEMBER 2001– FEBRUARY 2002

The work of the Kiev Project Office in the 8th Quarter was dominated by support for the WEM Concept Commission, including in the production of written documents. The documents produced for the use of the WEM Concept Commission are summarized in Annex G, listing titles and dates of diverse versions of each document. For this Annex D in the 8th Quarter Report, we list only “other” documents, that were produced for primary purposes other than support of the WEM Concept Commission.

KORNELIYA MOKANU
ATTORNEY

DATE	PRODUCT
1 March 2002	Memo on the PSA requirement for oblenegros to preserve the number of employees
7 March 2002	Comments on the application of the PRG
13 March 2002	Summary on alternative scheme of PRG application
18 March 2002	Comments on the issue of the list of customers prohibited from disconnection
20 March 2002	Comparative tables on OSA and Project Support Agreement in Sea Launch Project
26 March 2002	Memo on emergency reserve and extrahazardous objects
3 April 2002	Memo on prohibition to disconnect water supply and drainage facilities
8 April 2002	Memo on value added tax deduction from commercial losses
11 April 2002	Table on the European Integration: Does Ukraine meet requirements of European Directives?
12 April 2002	Memo on new Land Code requirements
16 April 2002	Summary for Task Force Meeting on new Land Code [in English and Ukrainian]
22 April 2002	Summary for Task Force Meeting on the Cut-off of Water Supply Companies and Other Non-Paying Customers [in English and Ukrainian]
25 April 2002	Memo on the Harmonization of the Laws of Ukraine with the EU Electricity related Directives with the View of EU Integration
8 May 2002	Memo on the taxation of the investment component
14 May 2002	Memo on the Alternative Investor Risk Reduction Plan
20 May 2002	Comments to the NERC Draft Law
24 May 2002	Comments in table to the NERC Draft Law
28 May 2002	Summary on the Alternative Investor Risk Reduction Plan
31 May 2002	Comments in table to the draft Debt Restructuring Law

VLADYSLAV RASCHEPKIN
PROJECT ENGINEER

DATE	PRODUCT
27 March 2002	OF FINANCIAL CONTRACTS IN ELECTRICITY MARKETS
27 March 2002	Comparison of the input data for fuel prices used in the S&W study for K2R4 project, and in the H&W modelling of the economic dispatch of the Ukrainian TPP
28 March 2002	Modeling of the Stack Order for Economic Dispatch of the Thermal Power Units in the Ukrainian Wholesale Electricity Market
5 April 2002	OF FINANCIAL CONTRACTS IN ELECTRICITY MARKETS (amended)
14 May 2002	WHOLESALE ELECTRICITY MARKET PRICES IN UKRAINE (amended)

**LILIYA SURZHENKO
ATTORNEY**

DATE	PRODUCT
11 March 2002	Brief Report of the NERC Hearing held on March 11, 2002
12 March 2002	Notes of the WEM Board meeting held on February 28, 2002
15 March 2002	Brief report of the WG meeting on review of the WEM Members' Agreement provisions concerning division of proportional votes
19 March 2002	Memo on what are the market share limitations imposed by NERC
26 March 2002	Summary of the CMU Order No. 45-p
29 March 2002	Brief Report of the NERC Hearing held on March 29, 2002
2 April 2002	Memo on protection of Rivneoblenergo against customers' suits
10 April 2002	Analysis of the NERC Electricity Utilization Code
15 April 2002	Analysis of EU Directive and local legislation related to the licensing of construction of new generation capacity and unbundling and transparency of accounts of energy companies
18 April 2002	Memo on requirements to creation of insurance company
18 April 2002	Translation of the memo on requirements to creation of insurance company
12 May 2002	Analysis of the NERC Electricity Utilization Code and New Draft NERC Electricity Utilization Code
16 May 2002	Analysis of the Draft NERC Independence Law
16 May 2002	Brief Comments to the Draft NERC Law
17 May 2002	Joint Comments to the Draft NERC Law
21 May 2002	The most important comments to the draft NERC Law
21 May 2002	Basis for comments to the Draft NERC law
24 May 2002	Table of proposals to the Draft NERC Law in Ukrainian
27 May 2002	Table of proposals to the Draft NERC Law
29 May 2002	Memo on oblenergo's territory for licensed activities
30 May 2002	Additional comments to the licensing provisions of the Draft NERC Law
31 May 2002	Reply to Julia Weller's comments to the Draft NERC Law
31 May 2002	Chart of key characteristics of an independent and effective regulatory agency found in Ukrainian law and proposed legislation, including NERC Draft Law as of 15 May, 2002

ANNEX E
EQUIPMENT PURCHASES FOR COUNTERPARTS

ANNEX E.1 PURCHASES OF EQUIPMENT FOR THE NERC

On request of the NERC Hunton & Williams applied to USAID for permission to purchase two servers for the NERC. The list of the computer equipment is given in the table below. The JSC "Microsell" was determined as the winner of the tender for the supply of the servers. The delivery of the equipment took place on 8 April 2002 under the three-party contract # NERC-H-1. The total amount of the purchase without VAT was 26 477,10 USD. H&W applied to USAID for VAT and profit tax exemption and received it on 24 April 2002 pursuant to usual procedures.

Description	Part Number	Q-ty
ML350T02 P1266 512 M1 EURO	225861-421	2
PIII 1266/133 ML3XX ALL	231117-B21	2
512 MB Memory Kit (DIMM, 1x512/133 MHz, SDRAM)	128279-B21	2
36.4 GB Pluggable Ultra3 10K Universal Hard Drive (1")	176496-B22	8
ML350 G2 HPRPS EURO	237046-021	2
Dual Channel, Ultra3, 64-bit PCI Smart Array 532 Controller ALL	225338-B21	2
V570 Opal MPR EURO	228114-022	2

ANNEX F

WEM CONCEPT COMMISSION OVERVIEW

Background:

The 'Interagency Commission' on preparation of the concept on development and functioning of the wholesale electricity market of Ukraine was created by Cabinet of Ministers Resolution No.25-r of 24 January 2002. The Commission has 21 members, including representatives of ministries, advisers to the First Vice-Prime Minister of Ukraine, State Security Council, Cabinet of Ministers of Ukraine, Association of independent electricity supply companies, SE "Energoynok", electricity generation and supply companies, Antimonopoly Union, National Energy Company "Ukrenergo", NERC, Energy Consulting Group as well as a representative of the International Financial Institutions. Deputy Prime Minister Dubina is chairman of the Commission, NERC Commissioner Kotko is deputy chairman of the Commission.

Procedure:

At its first meeting, a permanent working group was created, consisting of consulting companies and representatives of NERC, Ministry of Fuel and Energy, and energy companies. During the subsequent meetings, the Commission discussed and approved the outline of the WEM Development Concept, the tabular analysis of the problems existing in the current WEM, and the first sections on aims and principles of the WEM Development Concept and the WEM itself. Importantly, the analysis of the existing problems recognizes that the current functioning of the WEM is severely inhibited due to (1) administrative interference into the market operation, dispatch, fuel supply and revenue allocation, (2) lack of competition in the generation market, (3) inadequate pricing, (4) a range of unresolved organizational, technical and tax issues. It is also recognized that the sector debt problem must be resolved as a precondition for any WEM design.

Decision on End State Model:

Based on an analysis of world experience and of European legislation the Commission decided that the strategic direction for the Ukrainian WEM should be a market based on bilateral contracts and a balancing market. It was recognized however, that this type of market cannot be established overnight.

Transitional Alternatives Considered:

For the transitional period, three models were proposed: the 'Full Pool Model', the 'Liberalized Single Buyer Model', and a 'Full Pool with direct contracts Model'. All three models would conform to the European Electricity Directive.

The '*Full Pool Model*' aimed to restore the intended market design chosen for Ukraine in 1996 before the Single Buyer features were introduced. This meant to remove the wholesale buyer/purchaser function from ESE (together with the upper level transit account); to effect proportional and direct payment relationships between generators and suppliers via the multi-lateral pooling and settlement agreement; to transform the market operator into an entity under control of the market members; to introduce competition into the generation market and to allow competitive price setting for generation. The model had additional features improving the technical operation of the WEM, as well as organizational changes. The main rationale for this proposed model was to realize, in a short time horizon, the benefits from the originally intended design of the Ukraine WEM, and to remove the costly distortions caused by administrative interference.

The '*Liberalized Single Buyer Model*' would keep in place the main Single Buyer function of ESE as well as the status of ESE as a government enterprise. At the same time, this model anticipates a reduction of the market share of this Single Buyer through allowing large customers, and later oblenergos, to conclude direct physical contracts with certain generators – initially with small CHP generators, and later also with the

nuclear operator (after certain pre-conditions have been met and nuclear generators would also take part in the daily bidding), and with thermal generators. The main rationale for this model is to keep the existing organizational set-up and system, while at the same time allowing some market opening and a gradual move to the prospective model.

The '*Full Pool with direct contracts*' was a combination of the two other models. It proposed to remove the Single Buyer function and establish a Pool with direct and proportional payments, but at the same time to reduce the market share of this Pool by introducing direct contracts between eligible customers and generators. The model contained substantial complications of the contractual set-up, proposing that the current Wholesale Market Members' Agreement be replaced by 'Agency contracts' and an Association Agreement of all market members.

Decision on Transitional Model:

On 11th June, the Commission considered the three transitional models, adopted the 'Liberalized Single Buyer Model'. The main arguments were

- Keeping the current organizational set-up and avoiding sudden changes (such as the new contract or institutional structure in the other models would have been) would best preserve the positive trends in collections and increase of competition observed over the past year.
- The model does not need a long preparation period and therefore some liberalizing elements – such as the allowance of direct contracts – could start within 4 month of adopting the Concept.
- The model would allow working through the complex procedures required for the final state model during the transitional phase, which would make the gradual and quicker.
- The model could accommodate crucial features of the 'Full Pool Model'.

An integral part of the decision of the WEM Commission on the transitional model was to require the Working Group to introduce into the model:

- The requirement that allocation of payments at the WEM level should be proportional to the payments due to each market member (the best device for this would be to fix the principle of proportional allocation by Law) ;
- The requirement to undertake measures to remove the current obstacles to competition, including measures directed at a liberalization of the fuel market;
- Obligatory credit cover requirements for market members;
- The transformation of the Market Operator from a government enterprise to a CJSC owned by the market members in conjunction with privatization of thermal gencos;
- Measures to establish features of the balancing market during the step by step introduction of direct contracts, leading to a gradual and relatively quicker move towards the end state model.

In the coming weeks, the working group will develop the chosen transition model to accommodate the above points, including specification of the crucial preconditions and implementation procedures necessary.

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
1	Debt	3.2.2.1 ³	Debts in the Wholesale Electricity Market and their imbalance Versions as of: 11.03.02; 13.03.02; 18.03.02; 19.03.02; 21.03.02; 02.04.02 Approved on 11.04.02	Achieved Accepted	1.1. Pose reasonable solutions to debt problem. 1.2. Assure that debts were recognized as a problem to be solved.
		6.2.5	Resolution of the problem of WEM entities' debts and their imbalance Versions as of: 15.04.02; 16.04.02; 25.04.02; 03.06.02; 18.06.02		
2	Full Current Payment	3.2.2.2	Insufficient current payment for electricity	Accepted - 1 Not achieved Not achieved Achieved Achieved	2.1. Credit cover 2.2. Remove Single Buyer [I] Introduce auditable accounts; Remove transit account upper level; Remove transit account lower level or Leave ESE as it is, but without money (as Market Operator, performing calculating functions, giving instructions to the bank) Remove transit account upper level Leave lower level transit accounts of oblenergos 2.3. Inverted block tariffs or similar 2.4. Disconnection Legislation

³ Items that begin with 3.2.2... correspond to the item 3.2 of the WEM Concept structure "Positive experience and problems, which prevent efficient operation of the Wholesale Electricity Market of Ukraine. Conclusions".

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
		5.	Strategic Directions of the Further Development of the Wholesale Electricity Market of Ukraine. Versions as of: 28.03.02; 05.04.02; 09.04.02; 11.04.02; 14.05.02		
3	Administrative interference in funds	6.2.8.	Elimination of administrative interference into the administration of cash flows in the Wholesale Electricity Market Versions as of: 24.05.02; 27.05.02; 10.06.02; 14.06.02; 18.06.02	Pending Pending	<i>3.1. Better legal basis</i> <i>3.2. Prevention, responsibility, monitoring of emergencies, and removal of emergencies</i> <i>3.3. Provide for proportional allocation of funds in the law</i>
		3.2.2.3	Administrative interference into the flow of funds in the wholesale electricity market.	Pending	
4	Taxes				

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
5	Competition in generation	6.1.3.	Making the market more open and development of competitive environment for electricity generators and suppliers Versions as of: 31.05.02; 14.06.02	Pending Not Achieved Accepted Pending Pending Achieved	5.1 Remove price cap on bids 5.2 Create fuel market 5.3 Introduce financial contracts 5.4 No interference into thermal bids 5.5 Prevent abuse of market power 5.6 Authorization procedure for new generators or tender 5.7 Make nuclear to bid
				Accepted	Responsibility for accumulating funds for decommissioning, safety, fuel cycle
				Achieved	5.8 Adopt procedure for opening the market for retail competition 5.9 Adopt procedure for switching suppliers
				Achieved	
		6.2.3.	Development of competitive environment for electricity generators and suppliers Versions as of: 22.05.02; 27.05.02; 31.05.02; 14.06.02; 18.06.02		
		3.2.2.5	Constraints for competition between electricity generators		
		3.2.2.18	Unequal conditions for creation of competitive environment in the electricity supply market		

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
6	Tariffs and Pricing	3.2.2.6	Imperfect system of pricing and tariff formation	Pending Accepted Achieved	<i>6.1 HV transmission tariffs method</i> <i>6.2 HV transmission financing</i> <i>6.3 Nuclear pricing</i> <i>(should include decommissioning, safety, fuel cycle)</i> <i>6.3 Time-of-use (TOU) tariffs – need for proper method</i> <i>6.4 Losses – keep new tariff method</i>
		6.1.4.	Improvement of tariff and investment policy Versions as of: 31.05.02; 17.06.02		
7	Restriction of solvent demand	3.2.2.7.	Restriction of solvent demand in the wholesale market (system of demand limitation)	Achieved Achieved Achieved	<i>7.1 Remove / revise resolution 441</i> <i>7.2 Limit electricity for nonpaying suppliers only</i> <i>7.3 System Services Market (Ancillary)</i> <i>7.4 Dispatch philosophy (prioritize technical disconnections based on payments; never ! disconnect paying solvent demand always call more generation / reserve)</i> <i>7.5 [Incentives] HV level</i> <i>7.6 [Incentives] oblenargo level</i>
		6.2.7.	Prohibition of limitation of the solvent demand in the Wholesale Electricity Market Versions as of: 15.04.02; 22.04.02	Achieved Achieved	

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
8	Guarantees of reliability	3.2.2.8	Absence of guarantees of reliability of electricity supply and quality of electricity	Achieved	8.1 <i>Introduce liability / responsibility for reliability</i>
				Pending	8.2 <i>Ensure enforceability for contract relationships</i>
				Achieved	8.3 <i>Agree to adopt a grid code</i>
				Achieved	8.4 <i>Require that the grid code require economic dispatch</i> <i>See also goal 11 and goal 19</i>
		6.2.12	Improvement of the system of contractual relations in the Wholesale Market. Ensuring the enforcement of contractual obligations between market participants Versions as of: 14.06.02; 17.06.02		
		6.2.13	Creation of the Grid Code that provides equal rights for the access to the network by all participants of the Wholesale Electricity Market Versions as of: 22.05.02; 13.06.02; 14.06.02		
9	Network losses				CC. See Goal 6.5

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
10	Metering	3.2.2.10	Imperfect system of commercial metering of electricity	Pending Not Achieved Achieved Achieved	<i>10.1. Need for proper Central Metering System Operator (CMSO)</i> <i>10.2 Costs (include IT costs)</i> <i>10.3 Improve infrastructure of the metering system</i> <i>10.4 Procedure for a data exchange</i>
		6.2.11	Phased introduction of new systems for commercial electricity metering and data exchange at all stages of electricity purchase/sale, determination of the sources of their financing Versions as of: 10.06.02; 14.06.02; 17.06.02		
11	Ancillary (system) services	3.2.2.11	Lack of the market of system ancillary services (capacity reserve, frequency regulation, voltage regulation etc.)	Achieved Accepted	<i>11.1. Assign ancillary services provider</i> <i>DD. Hydro – not generation, but system service provider</i> <i>Obligatory reserve (pending)</i> <i>11.2. Introduce separate contracts for ancillary services between Ukrenergo and services' provider</i> <i>Tender for system services' contracts</i>
12	Cross-subsidization	3.2.2.12	Cross-subsidization via wholesale price for electricity for: - residential consumers; - consumers that use differentiated tariffs; - electricity suppliers.	Pending Pending	<i>12.1 Remove cross-subsidization</i> <i>12.2 Social Benefit System</i>
		6.1.4?	Improvement of tariff and investment policy Versions as of: 31.05.02; 17.06.02		
		7.4?	Formation of pricing and tariff policy Versions as of: 29.05.02		

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
13	Contractual relationships				EE. See Goal 8.2
14	Administrative interference in governance	3.2.2.14	Administrative interference with market governance, and market entities' operation.	Not Achieved	14.1 <i>ESE – leave as it is ?</i>
				Not achieved	<i>or</i> <i>ESE – leave as it is, but without money</i>
				Accepted subject to Genco privatization	14.3 Transform ESE into CJSC
		6.2.8	Elimination of administrative interference into the administration of cash flows in the Wholesale Electricity Market Versions as of: 24.05.02; 27.05.02; 10.06.02; 14.06.02; 18.06.02	Not Achieved Pending	14.5 Transform WEM Board into Board of Independent Directors
			Table on world experience on percentage of shares of transmission company in the authorized (charter) capital of Market Operator - delivered		14.6 Re-write the Procedure for changing WEMMA
15	Regulation	3.2.2.15	Imperfect system of state regulation in electricity sector	Pending	NERC independence by Law <i>[Rada has classified NERC independence as related to European integration]</i>
		7.2	Licensing of types of activity in the electricity industry Versions as of: 29.05.02		
		7.3	Regulation of electricity export-import activity and transit Versions as of: 22.05.02		
16	Export / import	3.2.2.16	Electricity export, import and transit procedures are not sufficiently regulated and are not transparent	Achieved Achieved	16.1 Restrict monopoly 16.2 Licenses for Importers / Exporters

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
		6.2.10	Adjustment of procedures for carrying out export and import operations and transit of electricity, including improvement of customs legislation Versions as of: 17.04.02; 17.05.02; 24.05.02; 28.05.02; 19.05.02		
		7.5	Regulation of electricity export-import activity and transit		
17	Investment	3.2.2.17	Lack of an opportunity to create attractive investment climate for modern power capacities' construction due to uncertainty in stability of current legislation and due to the impossibility to recover invested funds and obtain profits	Not Achieved Pending Achieved	17.1 Capacity fee (proper rule) ⁴ 17.2 Release bid cap ⁵ 17.3 Phase out "investment component"
		6.1.4	Improvement of tariff and investment policy Versions as of: 31.05.02; 17.06.02		
		6.2.15	Creation of favorable conditions for the construction and modernization of the objects of the integrated energy system of Ukraine Versions as of: 23.05.02; 03.06.02		
18	Competition in supply	3.2.2.18	Unequal conditions for creation of competitive environment in the electricity supply market		See Goals 5.8 and 5.9
		6.1.3	Making the market more open and development of competitive environment for electricity generators and suppliers Versions as of: 31.05.02; 14.06.02		
		6.2.3	Development of competitive environment for electricity generators and suppliers Versions as of: 31.05.02; 14.06.02; 18.06.02		
19	Grid Code	3.2.2.19	Imperfect normative base for market entities' operation and dispatch within the Ukraine power system	Achieved	FF. Adopt the grid code, Also GG. See Goals 8.3 and 8.4
		5.3	Production and technological system of the Wholesale Electricity Market		

⁴ The Concept Commission has not dealt with this, but the NERC has separately dealt with the capacity fee issue.

⁵ The NERC has separately dealt with the bid cap issue

#	WEM Problem	Para. #	Document Title	Outcome	H&W Goals
20	Hedging of financial payment risks	3.2.2.20	Lack of insurance mechanisms for financial and payment risks of market participants	Achieved Achieved Achieved Achieved Achieved Achieved	<i>20.1 Define financial risks correctly</i> <i>20.2 Start with allocation of financial contracts (NERC)</i> <i>20.3 Trade financial contracts</i> <i>20.4 Exchange</i> <i>20.5 Regulation of wholesale power costs in retail tariffs</i>
		6.2.4	Creation of the mechanisms of hedging risks, including financial risks, in the Wholesale Market Versions as of:31.05.02; 17.06.02		

ANNEX G
TABLE OF RESULTS OF WEM CONCEPT DEVELOPMENT
PRIORITIZED ACCORDING TO HUNTON & WILLIAMS PROJECT OBJECTIVES

The table summarizes the work of Hunton & Williams in support of the “WEM Concept Commission”, and evaluates the degree to which Hunton & Williams have achieved their goals, as of the status of work of that Commission on June 13 2002. The Table is organized in sequence of the list of problems that the Commission identified needed to be solved in order to reform the WEM. The first two columns identify the name given to each of the problems, in the sequence identified by the Commission. The column “para.#” identifies the outline section of the Concept itself in which that problem is discussed. The Column “Document Title” identifies any written text corresponding to that section, which Hunton & Williams staff prepared for use by the Commission, in the course of preparation of the Concept. The final two columns identify the goals which Hunton & Williams set prior to the start of this process for each problem, and evaluate the degree to which each goal has been achieved.

The meaning of the terms under “Outcome” are as follows:

Accepted: The Concept Commission has accepted the result, as embodied in a written document that will be part of the published Concept.
Accepted – 1: The Concept Commission has accepted the principle but a written document has yet to be Accepted.
Achieved: The Working group has adopted a written document which has not yet been considered by the Concept Commission.
Pending: The Working Group has not yet adopted, nor rejected, a relevant document.
Not Achieved: The Commission rejected the relevant document, or, the Working Group rejected it and it was not reviewed by the Commission

ANNEX H
ANALYSIS OF GENERAL PROVISIONS OF DRAFT NERC LAW

Table of Comparison to the Draft Law of Ukraine “On the Bases of the State Regulation of Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine”

(Strange color variations in this Annex other than black or red are courtesy of Microsoft Corporation. If you know how to remove them, please let us know).

NERC’s Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
Section “Definition” is absent.	To insert section “Definitions”	HH. In order to avoid confusion.
<p>Article 1. The Principles of the State Regulation of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine</p> <p>State regulation of the Natural Monopolies and Related Markets in the Fuel and Energy Complex shall be based on the following principles:</p> <p>...</p> <p>Competence and disinterestedness of the persons that carry out this regulation; Transparency and publicity of the process of regulation of the natural monopolies and related markets in the fuel and energy complex of Ukraine.</p>	<p>To change as follows:</p> <p style="padding-left: 40px;">Competence and disinterestedness of the persons that carry out this regulation members of Commission;</p> <p>Transparency and publicity of the process of regulation of the natural monopolies and related markets in the fuel and energy complex of Ukraine.</p>	<p>The regulation is carried out not by persons (commissioners), but by the NERC as a body consisting of commissioners.</p>
	<p>To add article 2 with new paragraph as follows:</p> <p>“To create conditions to realize the goal of providing universal reliable electric service to all consumers”</p>	Steve’s comment as requested by the NERC
<p>Article 5. The Body that Carries out Regulation of the Natural Monopolies and Related Markets in the Fuel and Energy</p>		

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
<p>Complex of Ukraine</p> <p>The body to carry out regulation of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine shall be the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine (the NERC of Ukraine).</p>	<p>To change as follows:</p> <p>The body to carry out regulation of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine shall be the national regulatory commission of the natural monopolies and related markets in the fuel and energy complex of Ukraine - the National Energy Regulatory Commission of Ukraine (the NERC of Ukraine).</p>	<p>Article 11 of the Law of Ukraine "On Electricity Sector" has already stipulated that the National Energy Regulatory Commission of Ukraine is the body of the state regulation in the energy sector.</p>
<p>Article 6.</p> <p>Major tasks of the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex shall be:</p> <p>...Securing the right of the customers of electricity and gas sector for getting products and services of standard quality at reasonable prices;</p> <p>Participation in the formation and securing of the enforcement of a single state policy in the development and operation of the Wholesale Electricity Market, markets of natural gas...</p>	<p>To change as follows:</p> <p>Securing Protecting the right of the customers of electricity and gas sector for getting qualitative products and services of standard quality at reasonable fair prices.</p> <p>Participation in the formation and securing of the enforcement of a single state policy in the development and operation of the Wholesale Electricity Market, markets of natural gas...</p>	<p>1) The term "standard quality" may be interpreted as "the same quality" for all customers. While it is true that currently all customers receive only firm energy, in the future it may be possible to provide different types of services at different prices, as envisioned by Section 2 of Article 9 of Natural Monopolies Law.</p> <p>2) The NERC, supplies of goods and services and consumers thereof can be of different opinion on what is a "reasonable" price.</p>
	<p>To add article 6 with new paragraph as follows:</p> <p>"To develop and impose on enterprises operating in the electric sector public service obligations relating to such matters as security of supply, regularity, quality and price of supply and environmental protection as the NERC determines to be reasonably necessary to provide reliable universal service to all consumers"</p>	<p>Steve's comment as requested by the NERC</p>
<p>Article 7 Peculiarities of Subordination and Reporting of the National</p>		<p>Provisions of Article 7 of the Draft NERC Law should be included in Article 5 of the Draft Law "The Body that Carries</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		including the use of scheduling and dispatch software that accurately reflects the Market Rules. As well, the System Operator License would specify the obligation and mechanisms for purchasing of ancillary services, including reserves; as well as the responsibility of the System Operator for short term and long term reliability.
	To add the list of licenses with license for construction of new generation capacity.	<p>The Directive of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity requires that construction of a new generating capacity has to be regulated under an authorization procedure (licensing) and/or a tendering procedure. "Authorization and tendering must be conducted in accordance with objective, transparent and non-discriminatory criteria". <i>Id.</i>, art. 4. Authorization and tendering should meet the requirements, established in articles 5 and 6 of the Electricity Directive.</p> <p>Most of EU Member States have chosen licensing procedure. To our mind, authorization NERC to license construction of a new generating capacity is logical from the point of view of the NERC's powers in the sector.</p>
<p>4) Take part in the regulation of payment and settlement relations of the wholesale electricity market, and natural gas market;</p> <p>5) Set restrictions to combining by economic entities of activity types in the events envisioned by law.</p>	<p>4) Take part in the regulation of payment and settlement relations of the wholesale electricity market, and natural gas market;</p> <p>5) Set restrictions to combining by economic entities of activity types in the events envisioned by law;</p>	II. Functions listed under items 4, 5, 9 and 11 are qualified by the Electricity Law as powers: see art. 12 "Major Tasks and Powers of the NERC", part 2. Therefore, these items have to be included in Art.11
6) Develop and approve within its authority normative documents that are binding for the execution;	6) Develop and approve within its authority normative documents resolutions and orders that are binding for the execution;	JJ. All types of the NERC acts are to be listed.

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
7) Protect, within its authority, interests of the customers related with the prices for electricity and gas and the issues of reliability of supply and quality of services rendered by supply organizations;	7) Protect, within its authority, interests of the customers related with the prices for electricity and gas and the issues of reliability of supply and quality of services rendered by supply organizations the rights of electricity and heat consumers;	Protecting the interests of customers contradicts art.2, ¶2 of this Draft: “ensure the balance of interests of the state, natural monopoly entities and customers, consuming their products”. Electricity Law, art. 12, ¶ 6: “[The NERC shall] protect the rights of electricity and heat consumers”.
8) Form within its authority state policy in establishing prices for electricity and gas, tariffs for the transportation of the natural gas, oil and oil products, other substances through pipelines and distribution, supply and storage of the natural gas and determine conditions of the access of customers to the commodity produced by natural monopoly entities;	8) Form within its authority state policy in establishing prices for Establish and ensure implementation of the price and tariff policies for electricity and gas, tariffs for the transportation of the natural gas, oil and oil products, other substances fuels through pipelines, and distribution, supply and storage of the natural gas and determine conditions of the access of customers to the commodity produced by natural monopoly entities;	Under existing legislation the NERC has powers both to establish and to implement price and tariff policies in energy and fuel sectors. Natural Monopolies Law, art. 12, ¶ 4: “[The Commission’s tasks are] to establish price policy in the relevant sphere of regulation”. Electricity Law, art. 12, ¶5: “[Major NERC tasks are] to ensure implementation of the price and tariff policies in electricity sector”.
9) Consider the cases of the violation of license terms and administrative offence and take relevant decisions within its competence based on the results of the investigation;	9) Consider the cases of the violation of license terms and administrative offence and take relevant decisions within its competence based on the results of the investigation;	To be included in Art. 11 of this Draft. KK. See comment to item 4 above.
10) Control cross subsidizing in the activity of licensees of the entities of natural monopolies and limit their activity in the event of the violation of the license conditions;	10) Control cross subsidizing in the activity of licensees of the entities of natural monopolies and limit their activity in the event of the violation of the license conditions;	This NERC power is to be executed in the context of licensing powers.
11) Determine if the liquidation, reorganization in the form of a merger, affiliation, lease, transfer for management, acquisition or alienation of stocks (shares, parts) of the assets of entrepreneurial entities exceeding 25% is in conformity with the Conditions and Rules for carrying out licensed activity;	11) Determine if the liquidation, reorganization in the form of a merger, affiliation, lease, transfer for management, acquisition or alienation of stocks (shares, parts) of the assets of entrepreneurial entities exceeding 25% is in conformity with the Conditions and Rules for carrying out licensed activity;	To be included in Art. 11 of this Draft. See comment to item 4 above.

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
13) Consider applications for the permission to create, reorganize (merge, take over), liquidate natural monopoly entities (including business companies, associations, concerns and other amalgamations of enterprises), joining one or several business entities to the associations, transfer for management (use) of parts (shares, stocks) and assets (property) in the form of integral property complexes of business entities or their structural subdivisions and take decision based on the results of consideration according to the procedure envisioned by the legislation;	13) Consider applications for the permission to related to <u>creation, reorganization</u> (merge, take over), liquidation natural monopoly entities (including business companies, associations, concerns and other amalgamations of enterprises), joining one or several business entities to the associations, transfer for management (use) of parts (shares, stocks) and assets (property) in the form of integral property complexes of business entities or their structural subdivisions <u>on whether new owner of the assets might meet the requirements for carrying out of licensed activities.</u> and take decision based on the results of consideration according to the procedure envisioned by the legislation;	LL. To be included in Art. 11 of this Draft. This is very huge power. This power should be granted in the context of the NERC's licensing power and, therefore, limited to determination on whether the new owner of the assets – potential licensee meets the criteria for carrying out of licensed activities. As well, this Law should establish clear requirements to the entities, which apply to NERC for the license.
14) Coordinate the work on training specialists on the issues of electricity and gas markets, establish qualification criteria in respect to the persons that carry out professional activity in these markets and hold certification of these specialists;	14) Coordinate the work on training specialists on the issues of electricity and gas markets, establish qualification criteria in respect to the persons that carry out professional activity in these markets and hold certification of these specialists;	The list of activities subject to licensing envisaged in the Licensing Law does not provide professional activities licensing of which can fall within NERC's competence. See art. 9 of the Licensing Law.
16) Take measures to insure equal rights for the access to transmission lines by all entities of the markets of electricity, oil, gas and oil products and <i>other substances???</i> of all types of ownership;	16) Take measures to insure Ensure equal access rights to transmission lines of all entities in the markets of electricity, oil, gas and oil products and other substances? <u>fuels transported through pipelines of all types of ownership;</u>	1) <u>Water</u> as a substance is also supplied by pipelines (for water supply and drainage purposes). The NERC has nothing to do with water. 2) The Constitution, art.13, part 4, already stipulated that all types of ownership are equal and enjoy equal rights: "All subjects of the right of property are equal before the law".
20) Report to Verkhovna Rada on the annual basis	20) Report to Verkhovna Rada on the annual basis	Natural Monopolies Law, art. 13, ¶ 9 requires only [that the annual reports should be published: "[The commissions shall] public annual reports on the results of their activities and activities of the natural monopolies".
21) Develop and approve Utilization Code of energy and gas; <i>Gas Pipeline Code,</i>	21) Develop and approve Utilization Code of energy and gas; Gas Pipeline Code, standard agreements with	1) The Electricity Law nowhere states that electricity purchase, supply or transmission must be made based on the

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
<i>standard agreements with customers;</i>	customers;	<p>model contracts. No effective Law or presidential act empowers the NERC to approve any standard contracts, furthermore obligatory standard contracts. The Constitution of Ukraine provides that “no person can be forced to do what is not envisaged by legislation”. <i>Id.</i>, art. 19, part 1. Approving mandatory model contracts by the NERC means not only its interference with economic activities of the business entities, but also violation of the <i>principle of the freedom of contract – a general principle of the civil law</i>. Although the old soviet Civil Code currently in force does not declare this principle straightforward, the latest Bill on the Civil Code of Ukraine non-signed by the President expressively provides for this principle. The Law of Ukraine “On Enterprises in Ukraine” stipulates the content of that principle. Furthermore, the Law of Ukraine “On Enterprises in Ukraine” states: “Enterprises shall be free in their choice of a subject of an agreement, defining of obligations, any other conditions of commercial relations, which do not contradict law of Ukraine.” (article 21, item 1, part2).</p> <p>2) The customers’ rights protection measures are envisaged in the Electricity Law (for instance, <i>the electricity supply companies are prohibited to refuse the supply of electricity to customers situated within their territory, strong financial liability is established for interruption in electricity supply, other</i>). Therefore, the NERC function of protecting electricity customers is to ensure that the licensees are not violating the provisions of the law relating to protection of customers. To do that, the NERC is authorized by the Electricity Law <i>with powers to apply penalties, suspend and cancel the licenses of the licensees-violators</i>. So, the NERC already under the Electricity Law disposes the instrument for protection of those rights of the customers, which are established by the Law. The Law had no intention to oblige the NERC to protect all and any rights of the customers, but only those, which fall within its authority. The mandatory standard contract cannot be</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		<p>regarded as a tool to protect customers, because on the other hand it can be considered as a tool of creation of disadvantageous contractual conditions for electricity suppliers.</p> <p>3) As well, Draft Commercial Code, article 179, does not oblige to establish standard agreement for electricity supply either: "Entities of economic activities, which provide electricity supply to the customers ... shall be obliged to conclude agreements with all their customers. The law of Ukraine <u>may</u> stipulate obligatory conditions of such agreements."</p> <p>4) As well, the principle of free choice of supplier should be observed.</p>
22) Coordinate activity of the state power bodies on the issues of natural monopolies and relevant markets in the fuel and energy complex of Ukraine;	22) Coordinate activity of the state power bodies on the issues of natural monopolies and relevant markets in the fuel and energy complex of Ukraine.	Natural Monopolies Law does not provide for neither function, no power of the commissions regulating monopolies to coordinate whatever activities of other state agencies.
<p>Article 11. Powers of the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex</p> <p>The NERC shall have the right to:</p> <p>6) Ensure control over the quality of services of the organizations that supply electricity and natural gas;</p>	<p>To change as follows:</p> <p>6) Ensure control over the quality of services of the organizations licensees that supply electricity and natural gas;</p>	The control powers of the NERC expend over licensees only.
7) Establish, within its authority, obligatory norms of sufficiency of the funds of business entities that obtain licenses, other indices and requirements that reduce the risks of transactions at the wholesale electricity market, natural gas market;	7) Establish, within its authority, obligatory norms of sufficiency of the funds of business entities that obtain licenses, other indices and requirements that reduce the risks of transactions at the wholesale electricity market, natural gas market;	The funds requirements to the business entities are established in the Law on Business Entities. If this provision intends to regulate selection of independent power suppliers, this has to be done by means of licensing criteria.
8) Take decisions on imposing penalties on the natural monopoly entities and economic	8) Take decisions on imposing penalties on the natural monopoly entities and economic entities that carry out	The application of penalties is to be based on legal grounds.

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
entities that carry out activity in the related markets;	<p>activity in the related markets, in cases envisaged by the Laws of Ukraine;</p> <p>To add as follows:</p> <p>9.1) Issue, suspend and revoke licenses in accordance with the legislation of Ukraine;</p> <p>9.2) Establish tariffs for licensees in regulated activities;</p> <p>9.3) Control observation by the licensees of the license terms.</p>	<p>To be included. This is one of the main NERC powers.</p> <p>To be included.</p> <p>To be included.</p> <p>NERC powers, indicated in items 8, 9.1, 9.2, 9.3 proceed from the Electricity Law, art.11, part 1: "The state regulation of activities in the field of the electric energy shall take place by means of issuing licenses for certain activities in the field of the electric energy, the development of the tariff policy, the specification of the procedure of the control over activities of subjects of the electric energy sector, and other members of the electric power wholesale market, and their liability for the violation of conditions and rules of exercising the activities at the electric power wholesale market."</p>
	<p>9.4) Set restrictions to combining by economic entities of activity types;</p> <p>9.5) Approve agreement between members of the Wholesale Electricity Market of Ukraine, changes and amendments to it;</p> <p>9.6) Settlement disputes between licensees and customers and licensees and licenses</p>	<p>To be included. This power of the NERC is envisaged in the Electricity Law, art.12 "Major Tasks and Powers of the NERC," part 2.</p> <p>To be included. This NERC power proceeds from its function envisaged in Art.10 of the Draft "15) Take part in the establishment of rules for the operation of the Wholesale Electricity Market, oil and gas markets and in the control over their observance pursuant to Ukrainian laws".</p> <p>WEM Members' Agreement partially envisages such NERC's authority:</p> <p>"A Market Member shall be permitted to appeal to the NERC in respect of any decision made at a General Meeting, within 30 days of such a decision and if Market Members with</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		<p>aggregate Weighted Votes of more than 10 per cent of Total Votes agree to such an Appeal... ” Item 5.3. As well, item 27.7 states: “The decision of the Disputes Committee in respect of any Notified Issue can be appealed to the NERC...”</p> <p>NERC Licenses for regulated and non-regulated supply also envisage that in the event of disputes between supplier and a customer or legal entity, issues, which are not resolved via negotiations, shall be submit for the NERC’s considerations according to the NERC’s competence.</p> <p>Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity provides that there should be designated a competent authority, which must be independent of the parties, to settle disputes relating to the contracts and negotiation in question. In particular, this authority must settle disputes concerning contracts, negotiations and refusal of access or refusal to purchase.</p>
	<p>9.7) Take part in the regulation of payment and settlement relations of the wholesale electricity market, and natural gas market; Ensure that payments and settlements of accounts in the wholesale electricity market, oil and gas markets are made in compliance with the legislation of Ukraine;</p> <p>9.8) Consider the cases of the violation of license terms and administrative offence and take relevant decisions within its competence based on the results of the investigation;</p> <p>9.9) Determine if the liquidation, reorganization in the form of a merger, affiliation, lease, transfer for management, acquisition or alienation of stocks (shares, parts) of the assets of entrepreneurial entities exceeding</p>	<p>To be included. These powers of the NERC is envisaged in the Electricity Law, art.12 “Major Tasks and Powers of the NERC”, part 2.</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
	25% is in conformity with the Conditions and Rules for carrying out licensed activity;	
13) Execute other powers pursuant to the legislation.	13) Execute other powers pursuant to the legislation envisaged by the Laws of Ukraine.	The NERC can derive its powers from the Laws only.
<p>Article 11. Powers of the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex</p>	<p>To add the following language in the end of the Article 11:</p> <p>“Powers stipulated by items 8, 9.1, 9.2, 9.3 of this Article are exclusive.”</p>	<p>Article 11 of the Law of Ukraine “On Electricity Sector” stipulated how state regulation of the electricity sector shall be carried out:</p> <p>“The state regulation of activities in the field of the electric energy shall take place by means of issuing licenses for certain activities in the field of the electric energy, the development of the tariff policy, the specification of the procedure of the control over activities of subjects of the electric energy sector, and other members of the electric power wholesale market, and their liability for the violation of conditions and rules of exercising the activities at the electric power wholesale market.</p> <p>As well, Law of Ukraine “On Electricity Sector” stipulated the NERC as a sole body of the state regulation in the electricity sector.</p> <p>MM.</p> <p>Thus, as a sole body of the state regulation in the electricity sector, NERC should be empowered with the exclusive powers, which it shall exercise independently of all other state bodies (including the Cabinet of Ministers of Ukraine).</p> <p>As for the Cabinet of Ministers’ competence, it is important to mention that the Decree of the President of Ukraine “On the Concept of Administrative reform in Ukraine” No. 810/98 dated July 1998, states that in terms of competence the Cabinet of Ministers is a body of general competence.</p> <p>As well, Draft Law “On the Cabinet of Ministers” does not provide for specific provision on the Cabinet of Ministers relationship with executive power bodies with special status.</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		<p><i>Thus,</i> 1) <i>the Cabinet of Ministers has general authority as compared to the NERC;</i> 2) <i>the Cabinet of Ministers directs and coordinates NERC's work within its general competence;</i> 3) <i>the Cabinet of Ministers in its activity is governed by the Constitution of Ukraine, laws of Ukraine, acts of the President of Ukraine.</i></p> <p>Therefore, if the NERC Law set up provisions on the NERC's exclusive powers, and that nobody has the right to interfere into the exercising of those powers, it would not contradict either Constitution of Ukraine or other laws or Draft Laws of Ukraine.</p>
<p>Article 12. Procedure for licensing in the fuel and energy complex</p>		<p>Provisions on licensing should be developed in detail, since the Law "On Licensing of Certain Types of Economic Activities" article 2, says that licensing in the electricity and nuclear sectors shall be carried out according to the laws, which regulate relations in those spheres.</p> <p>As well, Article 7 of the Law of Ukraine "On Natural Monopolies states: 'The activities of entities of natural monopolies as specified by Article 5 hereof and the economic activities of entities of adjacent markets shall be licensed according to the Law.'</p> <p>Thus, NERC Law is exactly the Law, which should provide for the licensing provisions, especially provisions on qualification criteria for applicants, conditions for revocation of license, etc.</p>
<p>Article 14. Guarantees of the Execution of the Authorities of the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine</p>	<p>1) To rename the Article 14 as follows: Article 14. NERC's relationships with the other bodies" Guarantees of the Execution of the Authorities of the National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine</p>	<p>In order to avoid a possibility of the Cabinet of Ministers' interference into the NERC's activities by means of implementation of the Cabinet of Ministers constitutional powers to direct and coordinate NERC's activities, as well as interference of all other bodies of executive power, it is very important to provide for the NERC's relationship with the</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
<p>The National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine shall perform its duties in compliance with the Constitution and Ukrainian laws independent of central and local state executive power bodies, local and regional self-governing bodies, their officials and entrepreneurs and public associations or their bodies.</p>	<p>2) To add the first paragraph as follows: "The Cabinet of Ministers of Ukraine, within its competence, shall direct and coordinate the work of the NERC."</p> <p>3) To change the first paragraph of the NERC's proposed language of Article 14 as follows: The National Regulatory Commission of the Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine shall exercise perform its duties exclusive powers in compliance with the Constitution and Ukrainian laws independently of all other central and local state executive power bodies, local and regional self-governing bodies, their officials and entrepreneurs and public associations or their bodies.</p>	<p>Cabinet of Ministers and other bodies of executive power.</p>
<p>Article 17, ¶ 2: Decisions and their substantiation shall be submitted to all interested parties. The decisions of great social significance shall be published in mass media.</p> <p>Article 17, ¶ 4: Decisions of the NERC of Ukraine should not be agreed upon by other central executive power bodies of Ukraine.</p>	<p>To propose the following language of article 17, ¶ 2: All the NERC's decisions and their substantiation shall be available to public.</p> <p>To propose the following language of article 17, ¶ 4: Decisions of the NERC of Ukraine should not be agreed upon by other central executive power bodies of Ukraine.</p>	<p>In order to ensure transparent NERC work, all the NERC's decisions should be available to public. Moreover, there is no criteria for the term "great social significance."</p> <p>The current version of article 17 of the Draft NERC Law does not eliminate Cabinet of Ministers interference into the NERC's decision making process, since according to the Constitution of Ukraine, the Cabinet of Ministers is the highest, not central, body in the system of bodies of executive power.</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
	To add Article 17 with paragraph 5 as follows: “NERC shall make a decision in the form of resolutions and orders. NERC’s decisions of normative character shall be issued in the form of resolution. NERC’s decisions on organizational, administrative and other issues of non-normative character shall be issued in the form of order.”	This provision makes clear in what form NERC’s decisions on each issue should be made.
Article 24. Responsibility of Economic Entities		Penalties imposed according to this article should be coordinated with the other legal acts in particular with the Law “On Electricity Sector,” article 24.
Article 25. Imposing penalties for the Violation of the “Electricity Law” and the “Natural Monopoly Law”		It is very important to set penalties proportionately to violation. Moreover, the Law of Ukraine “On Natural Monopolies” has already set up penalties for the same type of violations, which are much less than are being proposed by the Draft Law.

ANNEX I
ANALYSIS OF LICENCING PROVISIONS OF DRAFT NERC LAW

Table of Comparison to the Draft Law of Ukraine “On the Bases of the State Regulation of Natural Monopolies and Related Markets in the Fuel and Energy Complex of Ukraine”

NERC’s Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
Article 12. Procedure of Licensing in the Fuel and Energy Complex of Ukraine		<p>1) The Law “On Licensing of Certain Types of Economic Activities” article 2, says that licensing in the electricity and nuclear sectors shall be carried out according to the laws, which regulate relations in those spheres.</p> <p>2) Article 7 of the Law of Ukraine “On Natural Monopolies states: ‘The activities of entities of natural monopolies as specified by Article 5 hereof and the economic activities of entities of adjacent markets shall be licensed according to the Law.’”</p> <p>3) Thus, NERC Law is exactly the Law, which should provide for the licensing provisions, especially provisions on qualification criteria for applicants, conditions for revocation of license, etc.</p>
The Procedure for issuance and re-registration of licenses for carrying out entrepreneurial activity in the spheres of natural monopolies and related markets in the fuel and energy complex shall be determined by the Cabinet of Ministers of Ukraine upon the proposal of the NERC of Ukraine.	<p>To change as follows:</p> <p>The Procedure for issuance and re-registration of licenses for carrying out entrepreneurial activity in the spheres of natural monopolies and related markets in the fuel and energy complex shall be determined by the Cabinet of Ministers of Ukraine upon the proposal of the NERC of Ukraine.</p>	<p>The Law of Ukraine “On Electricity Sector,” article 13, part 2, stated that “Special permits (licenses), allowing generation, transmission, and supplies of electricity shall be issued by the National Electricity Regulatory Commission of Ukraine.” As well, part 3 of that Article states that “The license shall be issued on each type of activity separately according to the regulations, terms, and conditions adopted by NERC.”</p> <p>Since issuance of licenses shall be an exclusive power of the NERC, the Procedure for issuing and re-registration of licenses should be determined by the NERC, not the Cabinet of Ministers.</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
	<p>To add to Article 12 the second paragraph as follows:</p> <p style="padding-left: 40px;">The license shall be granted to an applicant who:</p> <ol style="list-style-type: none"> 1) is registered as an entity, which has the right to carry out entrepreneurial activity on the territory of Ukraine; 2) has at his disposal financial resources in the amount established by the NERC, which would guarantee proper conduct of economic activity, or is able to present documents proving his ability to acquire such resources; 3) has at his disposal property, which guarantees proper conduct of activity according to the NERC's licensing conditions; 4) has technical possibilities which guarantee proper conduct of activity according to the NERC's licensing conditions; 5) will guarantee the employment of persons with proper professional qualifications defined by the NERC's licensing conditions. <p>To add to Article 12 the third paragraph as follows:</p> <p style="padding-left: 40px;">Obtaining a license mentioned in the paragraph above shall not excuse the applicant from obtaining other licenses or permits required based on separate provisions according to the Ukrainian law.</p>	<p>The Law should establish clear requirements to the entities, who apply to NERC for the license.</p>
	<p>To add to Article 12 the fourth paragraph as follows:</p> <p>A license may not be granted to an applicant:</p> <ol style="list-style-type: none"> 1) <i>who undergoes insolvency or liquidation procedures;</i> 2) whose license for the activities determined by this Law was withdrawn within the period of last years. 	<p>The first provision would prevent coming of insolvent entities in the energy sector.</p> <p>As well, the second provision would ensure more level of responsibility from the side of the entity that operates in the market. Since, the licensee must realize that if his license is withdrawn, he could not obtain a new one within some period of time.</p>

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		This would also ensure more stable operation of the entities in the market.
Should this condition be provided for by Law, the time of license issuance can be prolonged up to 60 calendar days.		It is necessary to stipulate all the cases, when the time of license issuance can be prolonged up to 60 calendar days.
An application drawn with the violation of the established form or not complete with necessary documents shall not be subject to registration.	To delete.	If the Law provides for such provision, the Law should also contain a standard form of application, the list of documents that are necessary for consideration of application and the procedure for the license registration. The Draft Law fails to provide for those provisions. Moreover, all of those provisions most likely should be provided by regulations for issuance of licenses adopted by the NERC.
	<p>To add to article 12 the language as follows:</p> <p style="padding-left: 40px;">The license shall be withdrawn:</p> <ol style="list-style-type: none"> 1) upon a licensee's application; 2) if there is false data in the documents submitted by an applicant for obtaining the license; 3) if economic activities under the license are discontinued; 4) in the event when power company is divided or merges with other entities; 5) if the conducted activity is in gross default of the terms and conditions determined in the license and the power company holding the license has not cured the default ascertained by the regulatory authority within a period of time designated for curing such default; 6) if a legally valid court decision is imposed which cancel the state registration of the licensee as an entity of entrepreneurial activity. 	<p>The most important provisions on licensing in particular license's withdrawal should be clearly stated in the Law. Especially it is necessary, if the license's withdrawal is an obstacle for obtaining the same license within some period of time (see also proposals on who may not be granted with the license).</p>
One-time fee shall be paid for license issuance, which size shall be determined by the Cabinet of Ministers of Ukraine.	One-time fee shall be paid for license issuance, which size shall be determined by the Cabinet of Ministers NERC of Ukraine.	Article 13 of the Law of Ukraine "On Electricity Sector" has already stipulated that "The license shall be issued on each type of activity separately according to the regulations, terms, and conditions adopted by NERC."

NERC's Proposed Language of May 15, 2002	Comments of Hunton & Williams on the Proposed Language	Grounds for Comments
		Since issuance of licenses shall be an exclusive power of the NERC, the amount of one-time fee should be determined by the NERC
Regulation of economic activity in the fuel and energy complex of Ukraine shall be paid for on a quarterly basis, the amount of which shall be established by the Cabinet of Ministers of Ukraine.	To change as follows: Regulation of economic activity in the fuel and energy complex of Ukraine shall be paid for on a quarterly basis, the amount of which shall be established by the Cabinet of Ministers NERC of Ukraine.	Article 13 of the Law of Ukraine "On Electricity Sector" has already stipulated that "The license shall be issued on each type of activity separately according to the regulations, terms, and conditions adopted by NERC." Since issuance of licenses shall be an exclusive power of the NERC, the amount of a quarterly fee should be determined by the NERC. Moreover, NERC Rules and Conditions for regulated supply in particular have already provided for the NERC authority to establish current fee: "The amount and terms of payment of current fee shall be specified by NERC in accordance with the current law." Item 3.5.1. P.S. Current fee is paid by the licensees, which carry out electricity generation, transmission and supply.
Fine shall be charged for untimely payment of the quarterly fee in the amount of 1 % of the collected amount.	To change as follows: Each delayed day of quarterly fee payment shall be fined one percent of the quarterly fee.	According to the Ukrainian law, fine is imposed on a daily basis. Thus, the Draft Law should be amended respectively. As well, depend on the amount of the quarterly fee, it would be necessary to calculate the amount of a fine on whether it is not too big.

ANNEX J
REPRESENTATIVE EXTERNAL ADVISORY DOCUMENT

Insert Here file “Annex J 8 Quarter Report”

ANNEX K
PRESENTATION OF DISPATCH ANALYSIS TO US EMBASSY MARCH 2002

Insert Here the PowerPoint Slides from the File “Annex K 8 Quarter Report”

**HUNTON &
WILLIAMS**



Prepared for:

U.S. Agency for
International Development

IQC No:

EEU-I-00-99-00033-00

Task Order No:

OUT-EEU-I-800-99-00033-00

Annex K
8th Quarterly Report

COMPARATIVE ANALYSIS OF UKRAINE THERMAL POWER GENERATION

BRIEFING TO US EMBASSY AND USAID

MARCH 28, 2002

OUTLINE OF PRESENTATION

I. WHAT WE MODELED

II. THE SUPPLY CURVE FOR THERMAL POWER

II.A. Economic Supply Curve

II.B. Technical Efficiency Supply Curve

III. COSTS OF INEFFICIENCY

III.A. Actual vs Pure Economy Dispatch (Compare Market Shares by Company)

III.B. Excess Price and Allocation of Benefits

III.C. Excess Fuel Use

III.D. Coal Miners Do Not Benefit

IV. HOW COULD IT HAPPEN?

V. COMPETITIVE STRUCTURE OF THE THERMAL INDUSTRY

V.A. Profitability by Company – Actual and Pure Economy

V.B. Risk from Control of a Range of Production By a Single Company

V.C. Other Competitive Risks

VI. HOW TO FIX THINGS

VI.A. Remove Demand Constraints

VI.B. Preliminary Ideas on Fuel Markets

VI.C. Adequate NERC Oversight to Detect Anti-competitive Behavior

I. WHAT WE MODELED

EXISTING WEM Operations, Especially Nuclear, Hydro
And Thermal Plant Dispatch Ranks and Uses

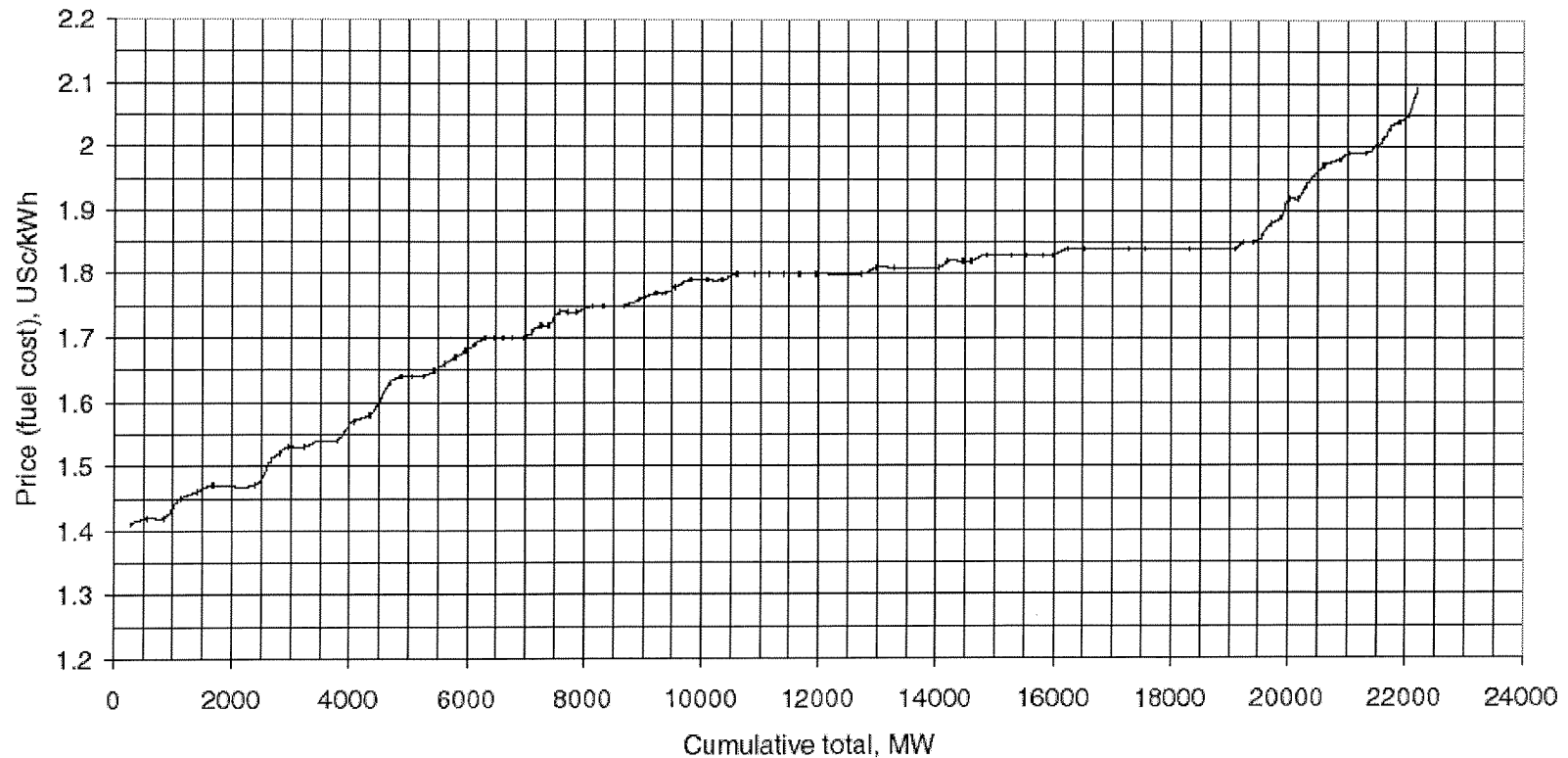
BUT As If the Thermal Plants Bid Marginal Costs
And As If Thermals Were Dispatched Efficiently

WITH Actually Applied Current Fuel Prices

OMIT Transmission Constraints and
Other Technical Operational Constraints

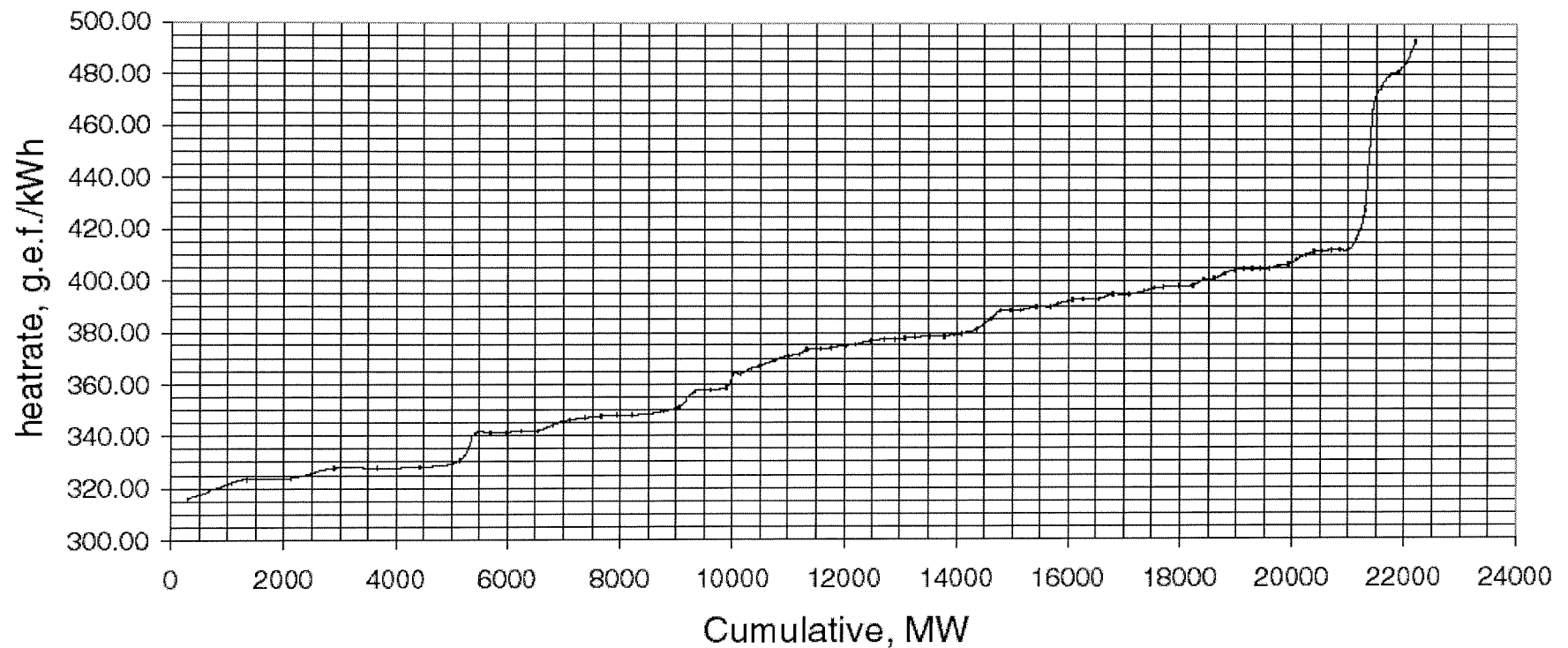
II.A. THE SUPPLY CURVE FOR THERMAL POWER

Ukraine Thermal Plant
Hourly Output Supply Curve
pure merit order economic dispatch



II.B. THE TECHNICAL EFFICIENCY STACKING ORDER OF THERMAL PLANTS

Ukraine Thermal Plant
Technical Efficiency Hourly Merit Order Curve



III.A. MARKET SHARES OF ACTUAL VS. PURE ECONOMY DISPATCH

	Market Share Economic	Market Share Actual	Difference of Actual less Economic	Ratio of Actual to Economic
Centrenergo	16.67%	27.90%	11.23%	1.67
Zakhidenergo	16.20%	16.03%	-0.16%	0.99
Dniproenergo	18.95%	26.87%	7.92%	1.42
<u>Donbassenergo</u>	<u>48/18%</u>	<u>29.20%</u>	<u>-18.99%</u>	0.61
Total	100.00%	100.00%	0.00%	
 Fifth Co.	 28.41%	 19.48%	 -8.94%	 0.69
Donbass net	19.77%	9.72%	-10.05%	0.49

III.B. EXCESS CONSUMER COST AND ALLOCATION OF BENEFITS

	Least Cost \$Millions	Actual \$Millions	Difference \$Millions	Explanation
1 Fuel Cost	1,025	1,128	103	Excess Revenue to Fuel Suppliers
2 Revenue	1,122	1,298	176	Excess Cost to Consumers
3 Net Revenue	96	170	73	Excess Net Revenue to Gencos
Avg. Unit Fuel	Cents	Cents	Cents	
4 Cost	1.58	1.74	0.16	Excess Revenue to Fuel Suppliers
5 Avg. SMP	1.73	2.00	0.27	Excess Price to Consumers
6 Net Per kWh	0.15	0.26	0.11	Excess Unit Net Revenue to Gencos

- Cash totals assume 100% cash payment and
- Ignore “leakage” of revenues due to algorithm adjustments.

III. C. EXCESS FUEL USE

DUE TO DISPATCH OF INEFFICIENT
PLANTS,
THE EXCESS FUEL CONSUMPTION
NEEDED
FOR THE SAME LEVEL OF OUTPUT IS:

12.8 %

OF TOTAL THERMAL COMPANY FUEL
USE

III.D. THE MINERS DO NOT BENEFIT

EVEN WITHOUT EXCESS SALES TO THERMAL PLANTS
THE THERMAL INDUSTRY PAYMENTS FOR COAL
ARE AT LEAST 2 TIMES MORE THAN NEEDED
TO PAY THE TOTAL COAL INDUSTRY COST FOR LABOR

	Hrv Billion
ENTIRE COAL INDUSTRY ANNUAL WAGES INCLUDING SOCIAL COSTS	1.218
TOTAL COAL COST TO THERMAL INDUSTRY	3.061
THERMAL INDUSTRY COAL COSTS IN EXCESS OF ENTIRE COAL INDUSTRY LABOR COST	1.843
TOTAL EXCESS COST OF ALL FUEL CHARGED THERMAL INDUSTRY DUE TO INEFFICIENT DISPATCH, @ 5.2 HRV/\$	0.564
EXCESS OF COAL INDUSTRY REVENUES NOT NEEDED TO PAY TOTAL COAL INDUSTRY LABOR COST THAT IS DERIVED FROM THERMAL INDUSTRY ALONE, EVEN IF ALL EXCESS THERMAL FUEL COSTS WERE FOR COAL AND WERE ELIMINATED	1.279

IV. HOW COULD IT HAPPEN?

Resolution 441

State Material Reserve Fuel Allocations

Resulting State Manipulation of Bidding

**Intentional Dispatch of Horribly Inefficient
Plants**

V.A. RELATIVE PROFITABILITY BY COMPANY

(net revenues over fuel costs on energy sales)

	ECONOMIC (\$MILLIONS)	ACTUAL (\$MILLIONS)	DIFFERENCE
Centrenerg	20.2	35.4	(15.15)
Zakhidenerg	5.5	26.4	(20.93)
Dniproenerg	15.8	44.8	(28.99)
Donbassenerg	54.9	63.2	(8.25)
<hr/>			
Total	96.4	169.7	(73.32)
Fifth Co.	36.0	44.2	(8.18)
Donbass net	18.9	19.0	(0.07)

V.B. RISK FROM CONTROL OF A RANGE OF PRODUCTION BY A SINGLE COMPANY

Controlling Company	Supply Range Affected MW	SMP Increase Potential	
		> 2 %	> 5 %
Donbass (5 th Co.)	0 - 1124	2.8 %	
Zakhid	2606 – 2946	4.1 %	
Dnipro	2947 – 4062	2.6 %	
Donbass (5 th Co.)	4337 – 5617		5.7 %
Donbass	6300 – 7903	2.4 %	
Centre	21429 – 21725	3.8 %	
Centre	21725 – 22007	3.1 %	
Donbass (5 th Co.)	22571 – 23316		6.5 %

V.C. OTHER COMPETITIVE RISKS

COLLUSION

PORTFOLIO EFFECT